



C O M M O D I T Y F U T U R E S

2006



FY 2006 PRESIDENT'S BUDGET AND PERFORMANCE ESTIMATE • FY 2006 PRESIDENT'S BUDGET AND PERFORMANCE ESTIMATE



T R A D I N G C O M M I S S I O N



Prepared for the Committee on Appropriations February 2005

THE FY 2006 PRESIDENT'S BUDGET & PERFORMANCE ESTIMATE

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Summary & Highlight Statement

February 7, 2005

The Honorable Thad Cochran
Chairman
Committee on Appropriations
United States Senate
S-128 Capitol Building
Washington, D.C. 20510-6025

The Honorable Jerry Lewis
Chairman
Committee on Appropriations
United States House of Representatives
S-218 Capitol Building
Washington, D.C. 20515-6015

Dear Chairman Cochran and Chairman Lewis:

I am pleased to transmit to you the Commodity Futures Trading Commission's Budget & Performance Estimate for FY 2006. This budget requests an appropriation of \$99,386,000 and 491 staff-years, an increase of approximately \$5,813,616 over the FY 2005 Appropriation of \$93,572,384¹.

Compared to the FY 2005 Appropriation, key changes in the FY 2006 Budget are:

\$+2.8 million to provide for compensation and benefits increases;

\$+3.0 million to provide for increases in costs for lease of office space, information technology modernization, and all other services at current service levels.

Congress created the Commodity Futures Trading Commission (the CFTC or the Commission) in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States (U.S.). The Commission's mandate was renewed and/or expanded in 1978, 1982, 1986, 1992, and 1995. In December 2000, the Commission was reauthorized by Congress and the President through fiscal year (FY) 2005 with the passage of the Commodity Futures Modernization Act of 2000 (CFMA).

The CFMA transformed the Commission from a front-line regulatory agency to an oversight regulator. Although the Commission's approach to regulation has consequently changed, its mission remains the same. The CFTC continues to be responsible for fostering the economic utility of futures markets by encouraging their competitiveness and efficiency, ensuring their integrity, and protecting market participants against manipulation, abusive trading practices, and fraud. Through effective oversight regulation, the CFTC enables the commodity futures markets better to serve their vital function in the Nation's economy—providing a mechanism for price discovery and a means of offsetting price risks.

In accordance with the Commodity Exchange Act (CEA), copies of this submission are also being transmitted to the Senate and House Appropriations Committees,

¹ Reflects net appropriation: (94,327,000 less .008% rescission = \$93,572,384)

the Senate Committee on Agriculture, Nutrition, and Forestry, and the House Committee on Agriculture.

I would be happy to meet with you to discuss this budget request and to answer any questions you may have about this request.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Sharon Brown-Hruska', written in a cursive style.

Sharon Brown-Hruska
Acting Chairman

Overview of Planned Outcomes by Strategic Goal

Introduction

The futures industry is experiencing a period of tremendous growth. Volume has increased almost 50 percent over the last two years and topped one billion contracts traded for the first time in history in 2002. The Commission's mission in the futures industry is to foster competitive and financially sound markets, to protect market users and the public from fraud, manipulation and abusive trading practices and to foster open, competitive, and financially sound markets.

The Commission requests \$99.4 million in FY 2006 to fund its efforts to reach its three strategic goals:

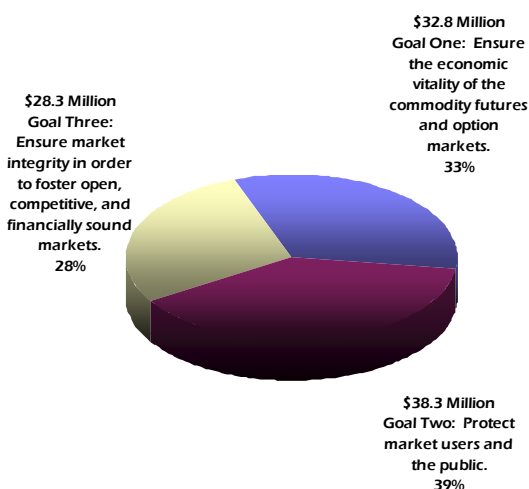


Figure 1: Budget & Performance Estimate by Strategic Goal

To achieve the planned outcomes for FY 2006, the Commission will allocate the \$99.4 million request among six programs: Enforcement; Clearing & Intermediary Oversight; Market Oversight; Chief Economist; Proceedings; and General Counsel. There is one support program: Executive Direction².

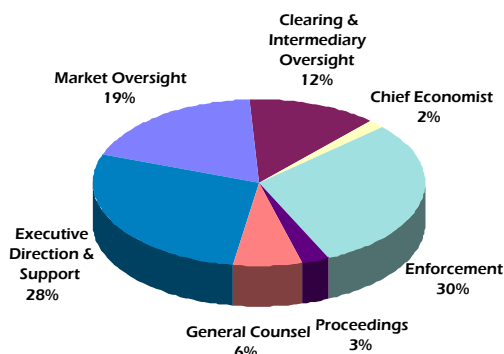


Figure 2: \$99.4 Million Budget Estimate by Program

² Includes information technology in support of all programs.

FY 2006 Outcomes by Goal

Goal One: Ensuring Economic Vitality of Commodity Futures & Option Markets

In seeking to fulfill its mission, a substantial portion of the Commission's resources are devoted to daily oversight of registered exchanges, intermediaries, and derivatives clearing organizations. In 1974, when the Commission was founded, the vast majority of futures trading took place in the agricultural sector. These contracts gave farmers, ranchers, distributors, and end-users of everything from corn to cattle an efficient and effective set of tools to hedge against price volatility.

Over the years, however, the futures industry has experienced increased complexity. While farmers and ranchers continue to use the futures markets as actively as ever to effectively lock in prices for their crops and livestock months before they come to market, new and highly complex financial contracts, based on such things as interest rates, foreign currencies, Treasury bonds, and stock market indices, have now far outgrown agricultural contracts in trading volume. Latest statistics show that approximately five percent of on-exchange derivatives activity is in the agricultural sector, while financial derivatives make up approximately 86 percent, and other contracts, such as those on metals and energy products, make up about nine percent.

In FY 2006, the Commission requests \$32.8 million to fund its efforts to reach the following outcomes of Strategic Goal One:

- Markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity—with an FY 2006 performance goal of zero price manipulations of other disruptive activities that would cause loss of confidence or negatively affect price discovery or risk shifting.
- Markets that are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality—with an FY 2006 performance goal of improving effectiveness and efficiency of market surveillance.

Breakout of Goal One Request by Outcome

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Ensure economic vitality of commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$25,005	136	\$28,301	144	\$3,296	8
1.2 Markets that can be monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.	5,496	29	4,507	22	-989	-7
Total Goal One	\$30,501	165	\$32,808	166	\$2,307	1

Figure 3: Breakout of Goal One by Outcome

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Goal Two: Protecting Market Users and the Public

While our country reaps the rewards of an explosive futures industry, never has the risk of fraud and manipulation been higher for market users and the public. The trend toward electronic trading platforms as well as the expanding complexity of trading instruments has challenged the Commission to reconfigure its ability to identify, investigate, and prosecute all parties involved in violating applicable laws and regulations. Typically, the Commission has over 100 investigations open at any particular time. If evidence of criminal activity is found, matters can and will be referred to state or Federal authorities for prosecution under criminal statutes.

Over the years, the Commission has prosecuted a number of cases involving manipulations or attempted manipulations of commodity prices. The Sumitomo copper case and the Hunt brothers silver case are well-known examples. A variety of administrative sanctions are available to the Commission, such as bans on futures trading, civil monetary penalties, and restitution orders. The Commission may also seek Federal court injunctions, asset freezes, and orders to disgorge ill-gotten gains.

In FY 2006, the Commission requests \$38.3 million to fund its efforts to reach the following outcomes of Strategic Goal Two:

- Violations of Federal commodities laws are detected and prevented—with an FY 2006 performance goal of increasing the probability of violators being detected and sanctioned.
- Commodity professionals meet high standards—with an FY 2006 performance goal of zero unregistered, untested, or unlicensed commodity professionals.
- Customer complaints against persons or firms registered under the Act are handled effectively and expeditiously—with an FY 2006 performance goal of resolving customer complaints within one year from the date filed and resolving appeals within six months.

Breakout of Goal Two Request by Outcome

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL TWO: Protect markets users and the public.						
Outcomes						
2.1 Violations of Federal commodities laws are detected and prevented.	\$27,923	141	\$28,413	136	\$490	-5
2.2 Commodities professionals meet high standards.	5,899	30	6,354	31	455	1
2.3 Customer complaints against persons or firms falling within the jurisdiction of the Commodity Exchange Act are handled effectively and expeditiously.	3,191	17	3,492	17	301	0
Total Goal Two	\$37,013	188	\$38,259	184	\$1,246	-4

Figure 4: Breakout of Goal Two by Outcome

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Goal Three: Ensuring Market Integrity in Order to Foster Open, Competitive, and Financially Sound Markets

The Commission also focuses on issues of market integrity, seeking to protect the: economic integrity of the markets so that they may operate free from manipulation; financial integrity of the markets so that the insolvency of a single participant does not become a systemic problem affecting other market participants; and operational integrity of the markets so that transactions are executed fairly and that proper disclosures are made to existing and prospective customers.

In FY 2006, the Commission requests \$28.3 million to fund its efforts to reach the following outcomes of Strategic Goal Three:

- Clearing organizations and firms holding customer funds have sound financial practices—with FY 2006 performance goals of zero loss of customer funds as a result of firms' failure to adhere to regulations and zero customers prevented from transferring funds from failing firms to sound firms.
- Commodity futures and option markets are effectively self-regulated—with an FY 2006 performance goal of zero loss of funds resulting from failure of self-regulated organizations to ensure compliance with their rules.
- Markets are free of trade practice abuses.
- Regulatory environment is flexible and responsive to evolving market conditions.

Breakout of Goal Three Request by Outcome

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL THREE: Ensure market integrity in order to foster open, competitive, and financially sound markets.						
Outcomes						
3.1 Clearing organizations and firms holding customer funds have sound financial practices.	\$6,016	31	\$6,183	30	\$167	-1
3.2 Commodity futures and option markets are effectively self-regulated.	11,663	63	12,618	64	955	1
3.3 Markets are free of trade practice abuses.	5,534	29	6,416	32	882	3
3.4 Regulatory environment responsive to evolving market conditions.	2,848	14	3,102	15	254	1
TOTAL	\$26,061	137	\$28,319	141	\$2,258	4

Figure 5: Breakout of Goal Three Request by Outcome

Summary of CFTC Mission Statement, Strategic Goals & Outcomes

<p align="center">Mission Statement</p> <p align="center"><i>The mission of the CFTC is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity futures and options, and to foster open, competitive and financially sound commodity futures and option markets.</i></p>	
<p align="center">Goal One</p> <p align="center"><i>Protect the economic functions of the commodity futures and option markets.</i></p>	
Outcomes	
1.	Markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.
2.	Markets that are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.
<p align="center">Goal Two</p> <p align="center"><i>Protect market users and the public.</i></p>	
Outcomes	
1.	Violations of Federal commodities laws are detected and prevented.
2.	Commodities professionals meet high standards.
3.	Customer complaints against persons or firms falling within the jurisdiction of the Commodity Exchange Act are handled effectively and expeditiously.
<p align="center">Goal Three</p> <p align="center"><i>Ensure market integrity in order to foster open, competitive, and financially sound markets.</i></p>	
Outcomes	
1.	Clearing organizations and firms holding customer funds have sound financial practices.
2.	Commodity futures and option markets are effectively self-regulated.
3.	Markets are free of trade practice abuses.
4.	Regulatory environment is responsive to evolving market conditions.

Progress Toward Outcomes in the Past Year

Progress in Implementing the CFMA

In December 2000, Congress passed the CFMA, which: 1) repealed the ban on single-stock futures and directed the Commission and the Securities and Exchange Commission (SEC) to implement a joint regulatory framework for futures on individual securities and narrow-based stock indices (security futures products); 2) codified the principal provisions of prior regulatory reforms adopted by the Commission; 3) brought legal certainty to trading in over-the-counter derivatives; 4) clarified the Commission's jurisdiction over off-exchange trading in foreign currency (or forex) futures and options; and 5) gave the Commission explicit authority to regulate derivatives clearing organizations (DCOs). The CFMA also reauthorized the Commission through the end of FY 2005.

Following passage of the landmark legislation, Commission staff began working to implement the CFMA by promulgating rules and conducting various studies (both independently and in coordination with other members of the President's Working Group on Financial Markets (PWG)) mandated by the CFMA, and the Commission worked closely with the SEC and the Board of Governors of the Federal Reserve System (FRB or the Board) to open the market to security futures products. During FY 2001, FY 2002 and FY 2003, the Commission proceeded to implement the requirements of the CFMA with proposed and final rules published in the *Federal Register*.

Implementation of the CFMA continued in FY 2004. Below is a brief summary of Commission actions taken during FY 2004.

- *Annual Report*. On March 12, 2004, the Commission submitted a report to the FRB concerning the exercise of authority delegated by the Board to the Commission and the SEC to prescribe customer margin rules for security futures products. In its delegation letter of March 6, 2001, the Board requested that the Commission and the SEC submit such an annual report. The SEC submitted a report on April 6, 2004. The FRB replied to the two reports on June 4, 2004.
- *Memorandum of Understanding (MOU) with the SEC*. In March 2004, the Commission and the SEC signed an MOU to clarify the ability of each agency to conduct inspections of notice-registered intermediaries, exchanges, and limited-purpose national securities associations. The MOU provides that the CFTC and SEC will notify each other of any planned examinations, advise the other of reasons for an intended examination, provide each other with examination-related information, and conduct examinations jointly, if feasible. The agencies will notify each other of significant market issues and will share trading data and related market information.

Pay Parity

The initial system of CT pay and benefits was fully implemented this past year and is now maintained by agency staff. These initial steps toward parity with other financial regulatory agencies, under authority of section 10702 of Public Law 107-171, the Farm Security and Rural Investment Act of 2002, consist of a revised pay system, flexible spending accounts, and a dental benefit program. In order to improve recruitment and retention and prevent the competitive gap in salaries and benefits with those of other financial regulators from widening, the CT pay plan received its first pay adjustment in September 2004, in line with that provided to the General Schedule in January 2004. Executed the flexible spend-

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ing accounts 2004 open season and with the aid of an expert firm, conducted agency-wide videoconference workshops for employees to learn optimal use of flexible spending accounts as part of their total benefits package. An agency committee, supported by a firm located through competitive bidding to provide benefits expertise, developed and implemented a dental plan to meet the legislative authority's standard of comparability to practices at agencies referred to in section 1206 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Enforcement

A primary goal of the Commission is to police markets for conduct that violates the CEA or Commission regulations. Such misconduct undermines the integrity of the markets and the confidence of market participants. The following matters are examples of significant developments during FY 2004:

Investigation of Alleged Misconduct in the Energy Markets. Through FY 2004, the Enforcement program has continued its extensive investigation of alleged abuses in energy-related markets. The investigation has focused on energy trading firms that have allegedly engaged in: 1) the reporting of false, misleading or knowingly inaccurate market information, including price and volume information; 2) attempted manipulation or manipulation; and/or 3) "round tripping," a risk-free trading practice that produces wash results and the reporting of non-*bona fide* prices, in violation of the CEA. The Commission's aggressive enforcement actions in the energy sector reflect an approach to market oversight that emphasizes tough enforcement actions against wrongdoers without creating overly burdensome regulations. The Commission is fully committed to resolving the ongoing energy investigations as expeditiously as possible so that, in addition to identifying the wrongdoers, we can exonerate those who were not involved and allow these important risk management markets to work toward restoring the confidence of market participants and the public.

As a result of its efforts in investigating wrongdoing in the energy markets, in FY 2004 alone the Commission filed a total of 12 enforcement actions resulting in \$121 million in civil monetary penalties. To date, these enforcement actions have resulted in civil monetary penalties totaling over \$297 million, among other sanctions, imposed against nearly 27 entities and individuals. The Commission's FY04 actions: *In re CMS Marketing Services and Trading Company, et al.*, CFTC Docket No. 04-05 (CFTC filed Nov. 25, 2003) (settled; \$16 million civil monetary penalty); *In re Reliant Energy Services, Inc.*, CFTC Docket No. 04-06 (CFTC filed Nov. 25, 2003) (settled; \$18 million civil monetary penalty); *In re Aquila Merchant Services, Inc.*, CFTC Docket No. 04-08 (CFTC Jan. 28, 2004) (settled; \$26.5 million civil monetary penalty); *In re ONEOK Energy Marketing And Trading Company, L.P., et al.*, CFTC Docket No. 04-09 (CFTC Jan. 28, 2004) (settled; \$3 million civil monetary penalty); *In re Entergy-Koch Trading, LP*, CFTC Docket No. 04-10 (CFTC Jan. 28, 2004) (settled; \$3 million civil monetary penalty); *In re Calpine Energy Services, L.P.*, CFTC Docket No. 04-11 (CFTC filed Jan. 28, 2004) (settled; \$1.5 million civil monetary penalty); *In re e prime, Inc.*, CFTC Docket No. 04-12 (CFTC filed Jan. 28, 2004) (a wholly-owned subsidiary of Xcel Energy, Inc.; settled; \$16 million civil monetary penalty); *In re Knauth*, CFTC Docket No. 04-15 (CFTC filed May 10, 2004) (settled \$25,000 civil monetary penalty); *CFTC v. NRG Energy, Inc.*, No. C.A. 04-3090 (D.Minn. filed July 1, 2004) (litigation pending); *In re Western Gas Resources, Inc.*, CFTC Docket No. 04-17 (CFTC filed July 1, 2004) (settled; \$7 million civil monetary penalty); *In re Coral Energy Resources*, CFTC Docket No. 04-21 (CFTC filed July 28, 2004) (settled; \$30 million civil monetary penalty); and *In re Byron G. Biggs*, CFTC Docket No. 04-22 (CFTC filed August 11, 2004).

Settled Energy Market Enforcement Actions. CFTC v. Enron Corp. and Hunter Shively, Civil Docket No. H-03-909 (S.D. Tex. March 12, 2003). On March 12, 2003, the Commission brought an injunctive action against Enron Corporation and one of its former traders, Hunter Shively, alleging that Enron and Shively engaged in a scheme that manipulated the Henry Hub Spot Market, which in turn had a direct and adverse effect on the New York Mercantile Exchange (NYMEX) natural gas futures prices. Specifically, the complaint alleged that Enron and Shively used Enron's former web-based electronic trading platform to buy an extraordinarily large amount of natural gas in a short period of time. The complaint further alleges that, immediately following the pre-arranged buying spree, Shively took various actions, including agreeing to cover trading losses of, and directing a payment from an account he controlled to, other traders involved in the scheme. As the complaint alleges, the manipulation of the Henry Hub Spot Market had a direct and adverse effect on the NYMEX August 2001 natural gas futures contract, including causing prices in NYMEX Henry Hub Futures to become artificial. Enron also offered an illegal agricultural futures contract on Enron Online (EOL) between at least December 2000 and December 2001. Enron offered a product on EOL it called the US Financial Lumber Swap but, in fact, it was an agricultural futures contract that was not traded on a designated exchange or otherwise exempt. Therefore the contract was an illegal agricultural futures contract.

On May 28, 2004, the Court entered a consent order of permanent injunction prohibiting Enron from violating various provisions of the CEA and ordered Enron to pay a \$35 million civil monetary penalty. On July 16, 2004, the Court entered a consent order of permanent injunction prohibiting Hunter Shively from violating provisions of the CEA and, pursuant to a settlement agreement between the Commission and Shively, Shively paid a civil monetary penalty of \$300,000.

In re Norman Eisler and First West Trading Inc. On January 21, 2004, the Commission accepted an offer of settlement from Norman Eisler, a former Chairman of the New York Futures Exchange (NYFE), and his trading company, First West Trading, Inc., in an administrative action alleging that respondents had manipulated NYFE settlement prices for the PSE Technology Index Option contract so as to inflate the value of the First West trading account by, on average, an excess of \$2 million each day. Eisler caused written reports of the false settlement prices to be disseminated to the NYFE and members of the public. The order required respondents to pay a civil penalty of up to \$4,923,000, revoked Eisler's registration with the Commission, barred respondents from trading on or subject to the rules of any registered entity, and imposed a cease and desist order against further violations.

Foreign Currency (forex) Trading Fraud. Fighting forex fraud continues to be a priority for the Commission. During FY 2004, the Commission continued its initiative to battle retail foreign currency fraud. While much foreign currency trading is legitimate, various forms have been touted in recent years to defraud members of the public. Under the CFMA, it is unlawful to offer off-exchange foreign currency futures or option contracts to retail customers unless the counterparty is a regulated financial entity enumerated in the CFMA, such as a futures commission merchant (FCM) or financial institution. In addition, the Commission has jurisdiction to investigate and prosecute foreign currency fraud involving futures or options. Currency trading scams often attract customers through advertisements in local newspapers, radio promotions, or attractive Internet Web sites. These advertisements may tout purportedly high return, low-risk investment opportunities or even highly paid currency-trading employment opportunities. The Commission has brought enforcement actions against both registered firms (both for fraud and for other CEA violations, such as failure to maintain net capital requirements) and unregistered bucket shops.

During FY 2004, the Commission filed 23 enforcement actions against firms and individuals selling illegal foreign currency futures and option contracts, bringing the total of such actions to 65 since enactment of the CFMA in December 2001. Among the Enforcement program's successes in this area was the May 28, 2004 District Court order of final judgment in a forex action brought by the Commission in July 2002. *CFTC v. International Financial Services (New York), Inc., et al.*, No. 02 CIV 5497 (S.D.N.Y. July 17, 2002). Among other sanctions, the court ordered the defendants to pay more than \$100 million in restitution and penalties for their violations of federal commodity laws.

Also, the Division played a central role in the eighteen month "Operation Wooden Nickel" undercover investigation into forex and bank fraud conducted by the U.S. Attorney and Federal Bureau of Investigation (FBI) in the Southern District of New York. On November 19, 2003, the U.S. Attorney filed criminal charges against 47 defendants and arrested many of them. At the same time, the CFTC filed six separate federal injunctive actions against 31 persons and entities. As part of the undercover operation, federal criminal agents infiltrated a forex boiler room in the World Financial Center allegedly operated by corrupt sellers of illegal forex futures contracts. The agents captured hundreds of hours of video and audio recordings of defendants allegedly scheming to deceive unsuspecting customers and steal millions of dollars. Operation Wooden Nickel is the largest undercover operation in which the CFTC has participated.

While the Commission has had great success in this area, forex scam artists are increasing in sophistication in their attempt to evade the Commission's jurisdiction. In addition, while not unique to the forex program area, the Commission has increasingly observed wrongdoers attempting to move misappropriated customer funds off-shore. See, e.g. *CFTC v. Emerald Worldwide Holding, Inc., et al.*, No. CV03-8339 AHM(Ex) (C.D.Cal. filed May 10, 2004) (in this forex fraud involving Japanese firm, Citibank agreed to reserve \$600,000 in order to compensate for funds it allowed a defendant to wire to Japan following service of the asset freeze).

The challenges are great, but so is our will to address this wrongdoing. The 23 forex cases filed by the Commission, thus far during FY 2004, include the following: *CFTC v. A.S. Templeton Group, Inc.*, NO. 03 4999 (E.D.N.Y. filed Oct. 1, 2003); *CFTC v. FX First, Inc., et al.*, No. SACV 03-1454-JVS(MLGx) (C.D.Cal. filed Oct. 6, 2003); *CFTC v. Bibas Levy Corp., et al.*, No. 03-22624 (S.D.Fla. Oct. 7, 2003); *CFTC v. Rowell*, CFTC Docket No. 04-02 (CFTC filed Oct. 15, 2003); *CFTC v. First Lexington Group, LLC, et al.*, No. 03 CV 9124 (S.D.N.Y. Nov. 18, 2003); *CFTC v. Bursztyn, et al.*, No. 03 CV 9125 (S.D.N.Y. Nov. 18, 2003); *CFTC v. Walter, Scott, Lev & Associates, LLC, et al.*, No. 03 CV 9126 (S.D.N.Y. filed Nov. 18, 2003); *CFTC v. ISB Clearing Corp., et al.*, No. 03 CV 9127 (S.D.N.Y. filed Nov. 18, 2003); *CFTC v. Madison Deane & Associates, Inc., et al.*, No. 03 CV 9128 (S.D.N.Y. filed Nov. 18, 2003); *CFTC v. Itradecurrency USA LLC, et al.*, No. 03 CV 9129 (S.D.N.Y. filed Nov. 18, 2003); *CFTC v. Emerald Worldwide Holding, Inc., et al.*, No. CV03-8339 AHM(Ex) (C.D.Cal. filed Nov. 17, 2004); *In re Yost, et al.*, CFTC Docket No. 04-07 (CFTC filed Dec. 22, 2003); *CFTC v. Erskine, et al.*, No. 1:04cv0016 (N.D. Ohio filed Jan. 6, 2004); *CFTC v. Clearview Capital Mgt., et al.*, NO. 04cv45(FSH) (D.N.J. filed Jan. 8, 2004); *CFTC v. Gibraltar Monetary Corp., et al.*, No. 04-80132 (S.D.Fla. filed Feb. 10, 2004); *CFTC v. FxTrade Financial, LLC, et al.*, No. 04-2181-Dan (W.D.Tenn. filed March 17, 2003); *CFTC v. E Net Speculation Ltd., et al.*, No. 3:04CV169-s (W.D.Ky. filed March 19, 2004); *CFTC v. Calvary Currencies LLC, et al.*, NO. 8:04-CV-01021-DKC (D.Md. filed March 29, 2004); *CFTC v. Lexington Royce & Associates*, No. 04 CV 02768 (S.D.N.Y. filed April 12, 2004); *CFTC v. Axess Trade Co., Inc.*, No. 04 CV 4293 (S.D.N.Y. filed June 7, 2004); *CFTC v. Sterling Financial Group, Inc.*, No. 04-21346 CIV-LENARD (S.D.Fla. filed June 7, 2004);

CFTC v. Next Financial Services Unlimited, Inc., et al., No. 04-80562 CIV-RYSKAMP (S.D.Fla. June 21, 2004); and *CFTC v. Global Atlantic Management, Inc., et al.*, No. 04-60797 CIV-JORDAN (S.D.Fla. filed June 21, 2004).

Commodity Pools, Hedge Funds, And Commodity Pool Operators. Investors continue to fall prey to unscrupulous commodity pools, hedge funds, and commodity pool operators (CPOs) that promise great riches with little risk and then, often, steal investor funds. Some of the scams are operated as “Ponzi” schemes³ in which early investors are paid purported “profits” with newer investor funds. In many of these cases the defendants have pre-existing business, social, religious, or ethnic ties to the individual investors. These personal relationships enable the defendants to gain the investors’ trust and then lull them into a false sense of confidence. The Commission addresses this violative conduct through a combination of enforcement actions and investor education.

Every year, the Enforcement program commits substantial resources to prosecuting such cases, many of which require immediate action to stop ongoing fraud, freeze assets, and preserve books and records. During FY 2004, the Commission filed the following actions in this program area: *CFTC v. Marquis Financial Mgt. Systems, Inc., et al.*, No. 03-74206 (E.D.Mich. filed Oct. 20, 2003); *CFTC v. Friedlander, et al.*, No. 03 CV 8319 (S.D.N.Y. filed Oct. 21, 2003); *CFTC v. Boston Trading Advisors, LLC, et al.*, CFTC Docket No. 04-03 (CFTC filed Oct. 27, 2003); *CFTC v. Clearview Capital Management, Inc. and James I. Weiss*, Civil Action No. 04 CV-45-(FSH) (D.N.J. January 13, 2004); *CFTC, et al. v. Silberstein*, No. 1:04-CV-666 (D.Md. filed March 5, 2004); *CFTC v. Equity Financial Group LLC, et al.*, No. 04CV1512 (D.N.J. filed April 1, 2004); *CFTC v. Weatherford*, No. CV04-4079 SJO(CWz) (C.D.Cal. filed June 8, 2004); *CFTC v. Vanguard Financial Mgt. Assoc., et al.*, No. SAVC 04-575(GLT) (C.D.Cal. filed May 19, 2004); *CFTC v. Nexgen Software Systems, Inc. and John P. Novak*, Case No. H-04-2947 (S.D. TX, July 20, 2004); *CFTC v. Charles L. Harris, Tradewinds International, L.L.C.*, Civil Action No. 04-C-5723 (N.D. Ill., filed September 1, 2004); *CFTC v. Edward R. Velazquez et al.*, Civil Action No. 04-C-5853 (N.D. Ill. September 8, 2004) *CFTC v. Vision Capital Corp., et al.*, Case No. 04CV00804 (D.Utah September 16, 2004); and *CFTC et al. v. Randall Nelson, et al.*, Case No. CV 04 B 2794 NE (N.D. Ala. September 23, 2004)

Natural Gas Price Spike Investigation.

In August 2004, the Commission completed its seven-month investigation of the sharp upward movement in prices in the natural gas market that occurred in late 2003. The CFTC’s investigation, which was initiated in early December 2003, did not uncover evidence that any entity or individual engaged in activity with an intent to cause an artificial price in natural gas in late 2003. According to the information obtained during the investigation, the increase in natural gas prices during that time was the result of distinct factors, including market reaction to colder than expected weather in the northeast U.S. during the first week in December 2003, and market statements and projections regarding the inventory of natural gas in underground storage caverns made in late November/early December 2003.

The CFTC’s investigation included the extensive review of documents and audio recordings produced by numerous companies and individuals in the natural gas markets, including physical and financial traders, industry analysts, and operators of natural gas storage facilities, as well as testimony and interviews of dozens of individuals.

³A Ponzi scheme is a type of fraud that requires an ever increasing stream of investors in order to fund obligations to the earlier investors, with a resulting pyramiding of the liabilities of the enterprise.

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Futures Commission Merchants and Introducing Brokers. The Commission diligently redresses fraud, misappropriation and other violative conduct by FCM and introducing brokers (IB). The Commission's efforts in this program area during FY 2004 include: *CFTC v. Keith Wilson Krynski*, Civil Action No. 03C 8571 (N.D. Ill. November 26, 2003). Defendant ordered to pay more than \$350,000 in restitution and to pay a \$60,000 civil monetary penalty; *CFTC v. Thomas D. Chilcott, d/b/a Trade Master of Southwest Florida, Ted E Whidden, and Leona Westbrook*, Civil Action No. 2:02-cv-94-FtM-29SPC (M.D. Fla. January 6, 2004). Defendants Chilcott and Westbrook ordered to pay \$2.1 million in restitution and more than \$1.43 million in civil monetary penalties, and defendant Whidden ordered to share liability for repaying customers and to pay a civil monetary penalty of \$990,000; *In re Steven G. Soule, Kyler F. Lunman II and Hold Trade Inc.* (CFTC February 11, 2004). Soule, Lunman and Hold Trade were ordered to pay \$276,557 in restitution to Coastal. Soule was ordered to pay a civil monetary penalty of \$276,000, and was permanently banned from trading; and Lunman and Hold Trade were ordered to pay a civil monetary penalty of \$250,000, Lunman was banned from trading for ten years, and Hold Trade was permanently banned from trading; *CFTC v. Kenneth Lee and KJL Financial Group, Inc.*, Case No. 4:02-cv-1477 CAS (E.D.MO. September 30, 2002). Defendants ordered to pay \$567,000 in restitution and to pay a civil monetary penalty of \$300,000; *CFTC v. Oscar Goldman*, Case No. CV-03-3265 JFW (RCx) (C.D.CA. May 9, 2003). Defendant ordered to pay \$95,500 to customers and to pay a civil monetary penalty of \$180,000; *In re Roy M. Sidewitz and Qi2 Technologies, Inc.*, Docket No. 03-18 (April 6, 2004). Respondents ordered to pay a \$25,000 civil monetary penalty; *CFTC v. E Net Speculation Ltd., Patrice Cornaz, and Athos Socratous*, Case No. 3:04-CV-169-S (W.D. KY March 19, 2004); *CFTC v. Commercial Hedge Services, Prime Trading Company and Lawrence Joseph Volf* (D. Neb. May 4, 2004). Defendants enjoined from violating provisions of the CEA and required to provide written disclosures to the farmers regarding their trading strategy; *In re William Scott Cordo and Mitchell Stephen Davis and First Investors Group of the Palm Beaches, Inc.* (CFTC May 24, 2004). defendants ordered Cordo to pay a \$480,000 civil monetary penalty and Davis to pay a \$120,000 civil monetary penalty; *CFTC v. First American Investment Services, Inc., Steve Knowles, Michael Savitsky, Greg Allotta, Adam Mills and James Eulowith*, Case No. CV04-60744 (S.D. FL June 7, 2004). Commission charged that defendants fraudulently solicited customers to trade options on commodity futures. The Commission alleged that customers lost more than \$12 million trading commodity options in 2002 and 2003, including more than \$6 million in commissions; *In re Harold Ludwig, William Rogers and Maria Toczykowski*, Docket Nos. 04-19 and 20 (CFTC July 13, 2004). Commission ordered defendants to pay more than \$11 million in restitution and more than \$4 million in civil monetary penalties for aiding and abetting a Ponzi scheme; *CFTC v. Carnegie Trading Group, Ltd., Inc., John Glase, John Hollenbaugh and Reid Henshaw*, Docket No. 1:04CV1403 (CFTC July 23, 2004). Commission charges defendants with customer solicitation fraud, including distribution to certain customers of a false and misleading advertisement regarding a proposed trading program; *CFTC v. Worldwide Commodity Corporation, Steven Labell, Joseph L. Allen, Bruce N. Crown and Phil Ferrini*, Case No. 04-CV-0461 (E.D. PA August 2, 2004). Commission charged that defendants fraudulently solicited customers to trade commodity options, resulting in customer losses of more than \$4 million; *CFTC v. Chase Commodities Corporation, Lee Lagorio and Excel Obando*, Case No. CV04-6463 (C.D. CA August 4, 2004). Commission complaint alleges that defendants fraudulently solicited customers to trade options on commodity futures contracts, resulting in customer losses of more than \$4 million, including more than \$2 million in commissions; *CFTC v. International Funding Association, et al.*, Case No. CV03-1826 (D. Ariz. July 29, 2004). The Commission had filed an action charging that, since 1997, Holt and his companies had defrauded customers of as much as \$25 million by claiming returns of seven percent to 10 percent per month, when the defendants, instead, allegedly misappropriated most customer funds

and also had offered illegal off-exchange futures contracts to the public; *CFTC v. Wilshire Investment Management Corporation, Andrew Alan Wilshire, Eric Scott Malcolmson, James Joseph Russo, and National Commodities Corporation, Inc.*, Case No. CV04-80862 (S.D. FL. September 14, 2004); *CFTC v. Liberty Financial Trading Corp., et al.*, Case No. 04-61235 (SD FL. September 21, 2004). Complaint alleges that defendants fraudulently solicited customers to trade commodity options contracts; *In re Steven Matrix* (CFTC October 7, 2003). The Commission accepted respondent Steven Matrix's offer of settlement and ordered him to pay a \$15,000 civil monetary penalty. Complaint alleged that respondent fraudulently solicited clients through his Web site to purchase a trading system manual with chart updates and e-mail support, by representing that he had actually earned profits while trading commodity futures according to that system when, in fact, he had not; and *CFTC v. Stephen A. Schmidt, TradeWins Publishing Corp., Shri Krishna Investment Research Corporation, and Anand Inamdar*, Case No. CV04-3081 (E.D.N.Y. July 20, 2004). Complaint alleges that defendants fraudulently promoted a trading system, including representations that trades posted on the Web site were actual trades. The complaint also charged that, by means of the alleged false claims, Schmidt and TradeWins violated a prior CFTC consent order issued against them in April 2002.

Trade Practice Actions. The legislative history of the CEA notes that one of the fundamental purposes of the Act is to ensure fair practices and honest dealing in the futures market and to control those forms of speculative activity that demoralize the market to the detriment of producers, consumers, and the markets. Consistent with Congress' mandate, the Commission brings trade practice cases to address a variety of unfair, abusive, or deceptive ploys by traders to avoid exposing their orders to market risk. Such actions can create non-competitive prices in the marketplace and have the potential to harm public customers, producers, and others. Improper trade practices include a variety of activities, including trading done in violation of exchange rules, such as trading ahead of a customer order, wash trading, accommodation trading, and fictitious trading. Cases in this area during FY 2004 included:

In re Contrino, Disarro, Overland, and Paulino, Docket No. 02-13 (January 7, 2004). The Commission issued an order finding that Contrino, Disarro, and Paulino fraudulently executed trades in the coffee futures ring of the Coffee, Sugar & Cocoa Exchange (CSCE). Contrino, Disarro, Overland, and Paulino were required to pay civil monetary penalties and were suspended as follows: Contrino—\$90,000 and four-month suspension; Disarro—\$50,000 and six-month suspension; Overland and Paulino—\$60,000 and six-month suspension each; *In re Robert Benjamin Harmon*, Docket No. 03-25 (January 16, 2004). The Commission issued an order against Robert Benjamin Harmon, Jr., finding that Harmon and another floor broker (FB) unlawfully executed crude oil futures trades on NYMEX. The Commission found that Harmon engaged in wash sales and reported non *bona fide* prices. Harmon was ordered, among other sanctions, to pay a civil penalty in the amount of \$8,500; *In re Olam International Limited*, Docket No. 04-13 (April 6, 2004). The Commission issued an order against Olam International Limited, a company incorporated in Singapore, based on illegal wash trading on the CSCE. The Commission found that on two occasions in June and July 2002, an Olam trader engaged in wash sales, and ordered Olam to pay a \$20,000 civil monetary penalty; *In re Barry Callebaut Sourcing AG*, Docket No. 04-16 (May 13, 2004). The Commission issued an order against respondent relating to illegal wash trading on the CSCE. The order found that on two separate occasions, in November 2001 and July 2002, Barry engaged in wash sales, and imposed a \$25,000 monetary penalty and other sanctions; *In re Daniel J. Collins, Thomas M. Gianos, Bernard Miraglia, John R. Wade, and Edward M. Collins*, Docket No. 94-13 (July 20, 2004). The Commission issued an order against respondents that found that that during the late 1980s, a trader established commodity futures intermarket spread transfer trades, as well as made

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fictitious and non-competitive transfer trades. The Commission permanently prohibited all respondents except Gianos from trading on or subject to the rules of a contract market, and barred respondent Gianos from trading for six months; *In re Izmir Mehmedovic*, Docket No. 04-23 (August 24, 2004). The Commission order found that on September 18, 2002, Mehmedovic violated the anti-fraud provisions of the CEA by knowingly engaging in at least one instance of trading ahead of an executable customer order. The order imposed various sanctions on Mehmedovic, including a \$10,000 civil monetary penalty, a three-month suspension of his floor broker registration, and an 18-month prohibition on trading for others; and *Credit Lyonnais Rouse Ltd.*, Docket No. 04-25 (September 29, 2004); *In re Fimat International Banque SA (UK Branch)*, Docket No. 04-26 (September 29, 2004); and *In re Refco Overseas Ltd.*, Docket No. 04-27 (September 29, 2004). The Commission issued an order in each of these actions that found that the respondent knowingly participated in illegal wash trading on the CSCE. Each of the respondents was ordered to pay a \$25,000 civil penalty and comply with specified undertakings.

Domestic Cooperative Enforcement. The Commission's cooperative enforcement efforts are an important part of its ability to promote compliance with and deter violations of Federal commodities laws. Cooperative enforcement enables the Commission to maximize its ability to detect, deter, and impose sanctions against wrongdoers involving U.S. markets, registrants, and customers. The benefits of cooperative enforcement include: 1) the use of resources from other sources to support Commission enforcement actions; 2) coordination in filing actions with other authorities to further the impact of enforcement efforts; and 3) development of consistent and clear governmental responses and avoidance of duplication of efforts by multiple authorities.

As in the past, staff of the Division of Enforcement have coordinated with numerous Federal, state, and self-regulatory authorities. Historically, program staff have sought assistance from or provided assistance to various Federal agencies, such as the Department of Justice (DOJ), Federal Bureau of Investigation (FBI), SEC, the U.S. Postal Inspection Service, and the Internal Revenue Service (IRS). Similarly, Division staff have provided assistance to and/or received assistance from state authorities, such as agencies responsible for the regulation of corporations, securities, and banking. The Commission also has provided Federal and local law enforcement authorities with testimony or other assistance in connection with criminal investigations. Enforcement staff have worked with DOJ and various U.S. Attorney's offices throughout the nation, the FBI, the offices of numerous state attorneys general, local police authorities, and task forces focusing on areas such as corporate fraud and foreign currency fraud.

International Cooperative Enforcement. The Commission continues to coordinate enforcement activities with foreign authorities. During FY 2004, the Commission made 113 requests for assistance to 56 foreign authorities, and it received 27 requests from authorities in foreign jurisdictions. In particular in FY 2004, the Commission was successful in freezing assets and obtaining bank records in several jurisdictions where we did not have prior cooperative relationships. Overall, during FY 2004, the Commission froze foreign assets totaling approximately \$4.1 million in five enforcement actions.

The Division also has devoted time and resources to matters involving cross-border activities necessitating assistance from the Commission's international counterparts. Such activities can adversely affect U.S. firms as well as customers located in the U.S. and overseas.

The Commission's international information-sharing arrangements enable the Commission and foreign authorities to engage in the bilateral sharing of information to assist each other in the investigation of potential wrongdoing that extends beyond their respective borders. During FY 2004, Division staff led efforts and

provided assistance to others in the Commission as the agency continued its work on the International Organization of Securities Commissions' (IOSCO) Multilateral Memorandum of Understanding (MMOU) Concerning Consultation, Cooperation, and the Exchange of Information. The MMOU is an important and meaningful undertaking for regulators to expand cooperation by establishing specific minimum standards for securities and futures regulators in the area of information sharing. There are 26 MMOU signatories, including nine foreign authorities with whom the Commission did not have an information-sharing arrangement previously.

Division staff, along with three other foreign regulators as members of a MMOU Verification Team, evaluated the applications of four IOSCO members to become signatories to the MMOU this year. The Commission also is part of the Screening Group that makes recommendations to a decision-making body of IOSCO concerning whether to accept or reject specific MMOU applications.

Division staff participated in the IOSCO Task Force on Client Identification to determine a range of acceptable options for client identification in the securities and futures industry. During FY 2004, Division staff also continued to participate in the Standing Committee on Enforcement and Information-Sharing (SC4) of the Technical Committee of IOSCO. SC4 considers issues and formulates recommendations relating to international assistance in the detection, investigation, and prosecution of securities and futures violations.

Kansas City Enforcement Office Opening. On January 9, 2004, the Commission expanded the enforcement staff of its regional office in Kansas City, Missouri. Prior to that time, the CFTC's Kansas City office had been staffed primarily by personnel from the agency's Divisions of Clearing and Intermediary Oversight and Market Oversight. The office now will include a team of experienced attorneys working to detect and prevent fraudulent and other illegal conduct relating to the commodity markets.

Spanish Language Consumer Advisory. On April 14, 2004, the Commission issued a Spanish-Language Consumer Advisory warning the public to be wary of a number of scams that falsely promise high profits with low risks, which may be targeted at ethnic communities in their language. At the same time, the Commission announced that its toll-free customer protection hotline had Spanish-speaking enforcement staff to respond to customers' inquiries and reports of possible suspect activity.

Regulatory and Legislative Matters

In FY 2004, Office of the General Council (OGC) continued to advise the Commission concerning implementation of the rules and regulations issued pursuant to the CFMA. OGC also continued its legal review of all exchange rule approvals, contract market designations, and derivatives clearing organization registration. In addition, OGC continued its review of requests for no-action relief to allow the offer and sale of foreign exchange-traded foreign stock index futures contracts in the U.S. In FY 2004, OGC issued four no-action letters for six of these foreign exchange-traded foreign stock index futures contracts. OGC also has been instrumental in advising the Commission as it comprehensively modernizes its rules governing FCMs, CPOs, CTAs and other registrants. Finally, OGC continued its legal review of no-action and interpretative relief proposed by the various Commission programs.

OGC, working in conjunction with other programs of the Commission, has consulted with staff of the U.S. Treasury Department and various Federal financial regulators to develop several anti-money laundering rules required under the USA PATRIOT Act, and to issue guidance regarding the implementation of those

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rules. During FY 2004, these included a final rule requiring FCMs and IBs to report suspicious transactions, and guidance regarding the application of the customer identification and verification rule for FCMs and IBs. OGC also has coordinated Commission outreach to market participants and SRO representatives to facilitate the presentation of comments and input to Treasury so that the resulting rules and guidance are appropriate to the nature of the industry, and Commission registrants are not placed at a competitive disadvantage relative to other financial services providers.

During FY 2004, OGC advised the Commission with respect to the legislative provisions affecting the Commission that were included in the Conference Report on the Energy Policy Act, H. Rept. No. 108-375. These included proposals to: 1) amend Section 4b of the Commodity Exchange Act to provide the Commission with principal-to-principal anti-fraud authority; 2) amend Section 9 of the Commodity Exchange Act to clarify the Commission's false reporting authority; and 3) add savings clauses to the Federal Power Act and Natural Gas Act to preserve the Commission's exclusive jurisdiction over market futures and options trading data.

Litigation

The Commission presents and defends cases before the U.S. District Courts and the U.S. Courts of Appeals and assists the Solicitor General in presenting cases before the U.S. Supreme Court. The Commission also monitors litigation that may affect the accomplishment of its mission, including its cooperation with other Federal financial regulators through the PWG and the President's Corporate Fraud Task Force.

During FY 2004, before the Courts of Appeals, the Commission obtained favorable rulings upon a variety of issues. Most notably, the U.S. Court of Appeals for the Ninth Circuit confirmed the Commission's view of the professional integrity necessary to work as a commodity professional. Specifically, the court affirmed a Commission opinion that held that an individual may be denied a license to work as a CPO or as a commodity trading advisor if that person has demonstrated a lack of honesty. *CFTC v. Stephen Bronte Advisors*, No. 02-73241 (9th Cir.) In another matter, the U.S. Court of Appeals for the Eleventh Circuit affirmed a district court finding of fraud in the retail sale of options contracts. *CFTC v. Matrix Trading Group*, No. 03-13123 (11th Cir.)

In a number of appellate matters, the OGC defended cases against violators of the Commodity Exchange Act who failed to return funds to defrauded customers, among them, *CFTC v. Heffernan*, No. 03-14494D (11th Cir.), *CFTC v. Kingsfield*, No. 03-2413 (4th Cir), and *CFTC v. Wall Street et al.*, No. 04-3131 (10th Cir.). In addition, on behalf of the Commission, OGC affirmatively sought review before the U.S. Court of Appeals for the Seventh Circuit of the core jurisdictional issue regarding the definition of a futures contract. *CFTC v. Zelener*, No. 03-4245 (7th Cir.)

Before the U.S. District Courts, OGC successfully defended the Commission's right to decide, subject only to appellate review, whether or not an individual has the requisite qualifications to serve as a floor broker in the commodities industry. *Hirschberg v. CFTC*, 2003 WL 22019310 (N.D.Ill.) In addition, OGC represented the Commission in personnel cases before the district courts and administrative agencies such as the Equal Employment Opportunity Commission and the Merit Systems Protection Board, and represented the Commission in contract matters before the General Services Board of Contract Appeals.

OGC also monitors bankruptcy cases involving futures industry professionals and, as appropriate, assists courts, trustees, and customers in implementing special Bankruptcy Code provisions that pertain to commodity firms. In FY 2004,

OGC appeared before various Bankruptcy Courts throughout the country to protect both the Commission's interest in recovering penalties owed due to market misconduct and the interest of public customers in having their funds recovered and returned. Most notably, during FY 2004, OGC appeared in bankruptcy proceedings involving several firms alleged to have engaged in misconduct in the energy markets. *In re Enron Corp*, No. 01-16034 (S.D.N.Y.); *In re NRG Energy Inc.*, No. 03-13024 (S.D.N.Y.)

Finally, through its *amicus curiae* program, OGC supports the Commission in assisting the courts in resolving difficult or novel questions arising under the CEA or Commission regulations with the intent of making significant contributions to the development of consistent and accurate legal precedent. In FY 2004, OGC actively considered participating as *amicus curiae* in one such case.

International Regulatory Cooperation

- Information Sharing. MOUs provide a framework for authorities to share information and extend assistance to one another in taking statements, collecting information, and conducting investigations. The Commission continued to use these arrangements to facilitate the sharing of information for enforcement and regulatory purposes throughout the fiscal year. During FY 2004, the Commission announced its participation in a multilateral MOU developed by IOSCO, and the entering into of a Statement of Intent between the Commission and the Irish Financial Services Regulatory Authority concerning consultation and cooperation. The Commission also entered into an arrangement for regulatory cooperation, consultation, and the provision of technical assistance with the Securities Exchange Board of India.
- Best Practices. The Commission also continued its active participation within IOSCO to develop regulatory "best practices" principles in the following areas that are intended to help foster higher international regulatory standards and increase access to markets and products:
 - Regulatory Oversight. The Commission continued its active participation in the IOSCO task force on the implementation of IOSCO's *Objectives and Principles of Securities Regulation (Core Principles)* that were adopted by IOSCO as a statement of international "best practices." The Commission chairs the IOSCO Implementation Task Force and, through this leadership position, led the drafting of a methodology to assess compliance with the IOSCO Core Principles, which were approved by the IOSCO Executive Committee, developed an electronic version of the assessment methodology to facilitate assessments by IOSCO members, participated in an IOSCO training seminar for members on use of the methodology, and provided background on the assessment methodology at a meeting of COSRA and of the Emerging Markets Committee of IOSCO.
 - Securities Settlement Systems. The Commission concluded its participation in a joint IOSCO-Basle Committee on Payment and Settlement Systems Task Force that has published recommendations for improving risk management and default procedures for central counterparties, such as futures clearing organizations together with an assessment methodology for measuring implementation of such recommendations..
 - IOSCO Standing Committees on Secondary Markets and Market Intermediaries. During FY 2004, the Commission continued its participation in IOSCO standing committees that have been ex-

amining regulatory issues affecting markets and intermediaries. Issues being examined for secondary markets include transparency of short selling, impact of index funds on markets, market impact of stock repurchase plans, transparency of corporate bond markets, error trade policies, exchange governance, and intermediaries. Issues being examined for intermediaries include, the regulation of financial intermediaries conducting cross-border business, outsourcing of financial services, issues under the revised Basle capital accords, and compliance functions of intermediaries.

- IOSCO Standing Committee on Enforcement and Information-Sharing. During FY 2004, the Commission continued to participate in IOSCO's Standing Committee on Enforcement and Information Sharing. This committee considers issues and formulates recommendations relating to international assistance in the detection, investigation, and prosecution of securities and futures violations, including methods to improve cooperation with offshore, "under-regulated" jurisdictions and cooperation between securities regulators after the institution of proceedings. The Commission actively participated in the development of a multilateral MOU that establishes minimum standards for cooperative enforcement and information exchange, including a demonstration of authority to obtain and share information, and the Commission continues to participate in implementation activities with respect to the multilateral MOU. Other activities during FY 2004 included examining methods to enhance cross-border cooperation in a litigation context, reviewing members' experiences with under-regulated and uncooperative jurisdictions, and the preservation and repatriation of property in cross-border cases.
- IOSCO Task Force on Client Identification and Beneficial Ownership. The Commission also participated in an IOSCO Task Force on Client Identification and Beneficial Ownership. The work of this Task Force led to the issuance of a report entitled, *Principles on Client Identification and Beneficial Ownership for the Securities Industry* in May 2004.
- IOSCO Standing Committee on Investment Management. During FY 2004, the Commission continued to participate in IOSCO's Standing Committee on Investment Management. Reports arising out of the work of this committee during the year addressed topics such as: investment management marketing and selling practices, investment management operational processes, index funds and the use of indices by the asset management industry, performance standards, management fees and commissions, and corporate governance practices.
- Chair's Committee of IOSCO. The Commission was invited for the first time to participate in the Chairs' Committee of IOSCO, which handles "fast-track" projects such as those related to governance, auditor independence, and disclosure relevant to lack of confidence in existing reporting and oversight of these items. During FY 2004 the Commission participated in Task Force meetings that have examined ways to strengthen capital markets against financial fraud and issues concerning the activities of credit rating agencies.

- Emerging Markets Committee. The Commission provided information on its approach to detecting and deterring manipulation to the IOSCO Emerging Markets Committee.
- Council of Securities Regulators of the Americas (COSRA). The Commission actively participates in COSRA, which is an organization of securities and derivatives regulators of North and South America. During FY 2004, the Commission participated in meetings where it contributed to discussions on advancing COSRA's training and technical assistance programs and a paper addressing the benefits of futures trading to the securitization of small business loans.
- Joint Forum. The Commission was invited for the first time in FY 2004 to participate on a Joint Forum project that is developing principles for outsourcing by financial services providers. The Joint Forum is an organization composed of senior representatives from securities, banking and insurance organizations.
- Promoting Access to Markets and Products. During FY 2004, the Commission provided representations and regulatory information to regulatory authorities in Australia, Austria, Germany, Italy, the Netherlands, Spain and Switzerland that supported the recognition of three U.S. futures exchanges electronic trading systems and provided regulatory information to assist Australian regulators in their determination to issue a blanket exemption to U.S. FCMs offering wholesale business in Australia. The Office of International Affairs (OIA) continues to pursue activities intended to make the rules and procedures of jurisdictions relating to access are clear and transparent.
- International Assistance and Cooperation. During FY 2004, the Commission continued to provide assistance to foreign regulators through its annual training seminar in Chicago, publications, individual training, visits by foreign regulators to the Commission to meet with staff, and other forms of assistance, including the annual International Regulators Meeting during the Futures Industry Association's (FIA) conference in Boca Raton, Florida. The meeting, attended in FY 2004 by regulators from 25 jurisdictions, focused on international regulatory approaches to governance and self-governance of organized markets. The Commission continued to advise the Toronto Centre on Leadership with respect to securities and derivatives sector programs and contributed to their first Executive Forum assembling securities, insurance and banking supervisors and regulators.
- Committee of European Securities Regulators. In 2004 the Commission and the Committee of European Securities Regulators (CESR) announced a *Transatlantic Cooperation Initiative (Initiative)* on cross-border issues. The purpose of the Initiative will be to: institute regular communication on matters of regulatory developments of common concern; heighten each respective region's attentiveness to the need for early and effective consultation; and explore where areas of convergence and of common interest permit the development of practical EU-wide mechanisms to enhance the existing bilateral relationships between the Commission and the individual CESR members.

The Commission also provided expertise to CESR related to its inquiry into acceptable market practices for commodity markets

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as part of its deliberations on possible expansion of the Investment Services Directive to commodity markets.

- Financial Sector Assessment Program. The Commission provided expertise to the World Bank/International Monetary Fund Financial Sector Assessment Program in countries with derivatives markets.

New and Innovative Exchanges

The Commission is faced with an increasing number of important issues concerning the impact of technological changes on methods of transacting business on futures exchanges and a proliferation of designation applications and exempt market filings for new electronic exchanges:

- U.S. Futures Exchange, L.L.C. (USFE or Eurex US). At a public meeting on February 4, 2004, the Commission designated, subject to conditions, the USFE as a contract market. This action was taken following review of the application and correspondence that included, among other things, 37 public comment letters. The USFE is owned 80 percent by a subsidiary of Eurex Frankfurt AG and 20 percent by a limited partnership of 17 shareholders, many of which were shareholders of the BrokerTec Futures Exchange, L.L.C., a designated contract market that ceased trading operations on November 26, 2003. The USFE trades U.S. Treasury futures and option contracts on an enhanced version of the a/c/e automated trading system, formerly operated in the U.S. as part of a joint venture between Eurex Deutschland and the Chicago Board of Trade (CBOT). The USFE contracted with The Clearing Corporation (CCorp) to provide clearing and settlement services and with the National Futures Association (NFA) to assist it in carrying out self-regulatory responsibilities.
- HedgeStreet. On February 18, 2004, the Commission designated HedgeStreet as a contract market for non-intermediated electronic trading in cash-settled, European-style binary options on various proprietary and non-proprietary indices. Trading on HedgeStreet is conducted over the Internet. The Commission concurrently approved HedgeStreet's application for registration as a derivatives clearing organization. HedgeStreet contracted with NFA to assist it in carrying out various self-regulatory responsibilities.
- New Exempt Commercial Markets. During the fiscal year, the Commission staff reviewed notice filings from, and issued acknowledgement letters to, four exempt commercial markets (ECMs). ECMs are electronic trading facilities that provide for the execution of futures transactions by eligible commercial entities in exempt commodities. A facility that elects to operate as an ECM must give notice to the Commission and comply with certain informational, record-keeping, and other requirements. The new ECMs are Commodities Derivative Exchange, Inc. (CDXchange), Natural Gas Exchange (NGX), SpectronLive.com Limited (Spectron), and TFS Pulp and Paper Division (TFS). CDXchange is based in Northfield, Illinois, and trades metal derivatives; NGX is based in Calgary, Alberta, and trades natural gas, electricity, and other energy derivatives; Spectron is based in London, England, and trades liquid petroleum gas derivative; and TFS is based in Stamford, Connecticut, and trades pulp and paper product derivatives.
- New Exempt Boards of Trade. Commission staff reviewed a notice filing and issued an acknowledgement letter to one exempt board of trade (EBOT), Actuarials Exchange, in January 2004. Actuarials Exchange is based in Chicago, Illinois, and intends to offer contracts based on London Interbank Offered Rate (LIBOR) rate futures. EBOTs are boards of trade that provide for the execution of futures contracts by eligible contract participants in excluded

commodities. A board of trade that elects to operate as an EBOT must give notice to the Commission and comply with certain informational requirements.

- *Exempt Commercial Market Requirements*. On July 13, 2004, the Commission adopted final rules relating to the responsibilities of ECMs. The rule-making had two central components. First, the Commission amended an existing regulation that governs Commission access to information regarding transactions on ECMs, to provide for access to more relevant and useful information from all such markets. Second, the Commission adopted new standards to identify when an ECM is performing a significant price discovery function for transactions in an underlying cash market and, consequently, will be required to publicly disseminate certain specified trading data.
- *Exempt Commercial Market Relief*. On March 22, 2004, the Commission requested comment on a request by the IntercontinentalExchange that the Commission deem brokers and traders that are United Kingdom (U.K.)-based members of the International Petroleum Exchange (IPE) to be "eligible commercial entities." This would allow those IPE members to enter into transactions in exempt commodities on ECMs that meet the requirements of sections 2(h)(3)-(5) of the Act. The Commission received three comment letters and additional submissions from IntercontinentalExchange.

New and Innovative Products

In FY 2004, the exchanges filed with the Commission 207 new futures and option contracts based on a wide variety of underlying physical products, financial instruments, and economic indexes. All new contracts were filed under the Commission's certification procedures whereby exchanges certify that their contracts comply with statutory and regulatory requirements. Many of the contracts represent innovative approaches designed to meet specialized hedging needs of producers, firms in various industries, or others. In that regard, exchanges filed a number of over-the-counter-like cash-settled natural gas and electricity futures contracts covering different regions of the U.S., as well as contracts based on ethanol, fertilizers, financial commodities, weather indexes, and a number of option contracts based on macroeconomic and regional indicators. Many of the option contracts based on economic indexes represented an innovative approach to derivatives trading, known as binary options whose payoffs are mutually exclusive and cover all possible outcomes. In addition, 29 security futures products were filed during the fiscal year.

Exchange Developments

- *Merger of CSCE and NYCE to Become NYBOT*. On June 9, 2004, the Commission approved: 1) new bylaws and rule amendments for the CSCE and New York Cotton Exchange (NYCE), 2) approved the transfer to New York Board of Trade (NYBOT) of all contracts currently listed for trading on CSCE and NYCE and all associated open interest, and 3) transferred the existing CSCE and NYCE contract market designations to NYBOT. These actions were taken to implement CSCE and NYCE's plan to merge into NYBOT; the resultant, new designated contract market.
- *CME "Call Market"*. Commission staff reviewed Chicago Mercantile Exchange's (CME) self-certification of an enhanced system for electronic trading "call market" on GLOBEX of Eurodollar options, which became effective August 2, 2004. The call market uses an electronic request for quote function and combines committed market-making, indicative quotes, and complex spread combinations and trades at the same time as the floor.

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- *Transfer of CBOT, KCBT, and MGE Electronic Trading to the Euronext-Liffe Trading Electronic System.* In FY 2004, Commission staff reviewed CBOT's self-certification of new rules as well as provisions to facilitate the transfer of CBOT electronic trading to its new e-cbot trading platform using the LIFFE CONNECT technology. Minneapolis Grain Exchange (MGE) and Kansas City Board of Trade (KCBT) both contracted with CBOT to use CBOT's e-cbot trading platform. In FY 2004, the Commission staff reviewed KCBT rules to provide the necessary framework for the electronic trading of KCBT contracts on e-cbot.
- *Safe Harbor for Inadvertent Cross Trade.* On January 20, 2004, OCX Rule 616 was adopted to create a safe harbor that permits OneChicago (OCX) market makers to engage in business activities other than OCX market making activities, without violating OCX rules due to an inadvertent cross trade. Under the rule, the safe harbor applies only if a OCX market maker uses a "Chinese Wall" to separate market-making trading activity its business activities.
- *CME Three-Month Eurodollar Forward Rate Agreement Futures Contract.* Commission staff reviewed rules implementing a new futures contract submitted by the CME in May 2004 under certification procedures of the Act. The new contract filing included novel features under which the CME maintains a daily listing of contract expirations with trade matching on a weekly periodic basis. For each expiration, all orders are to be executed at a single price determined by a CME-developed trade-matching algorithm.
- *Error Trade Rules.* During the fiscal year, Commission staff reviewed amendments to floor broker error trade rules from the CBOT expanding assignment procedures for correction of certain broker errors trades. In addition to out-trades, assignment procedures are now available for other types of broker errors, including unfilled orders, under filled orders and wrong price executions.
- *Exchanges' Petitions to Repeal or Amend Federal Speculative Position Limits.* On June 17, 2004, the Commission published, for a 60-day public comment period, petitions by the CBOT, the Kansas City Board of Trade (KCBT), and the Minneapolis Grain Exchange (MGE) seeking repeal or amendment of the speculative position limits set out in Commission regulation 150.2 (Federal limits). In addition, the NYBOT, while not submitting a formal petition of its own, submitted a letter in support of the CBOT petition. The Commission will take into consideration comments from all interested parties, as well as other relevant materials and issues, before making a determination on whether to grant the exchanges' petitions.
- *Amendments to the CME Live Cattle Futures Contract.* In FY 2004, staff reviewed several actions related to the CME's live cattle futures contract. These included an expansion of daily price limits under certain circumstances, subsequent approval of an emergency action that temporarily expanded daily price limits following the U.S. Department of Agriculture's (USDA) announcement of the discovery of a dairy cow afflicted with Bovine Spongiform Encephalopathy (BSE or "mad cow" disease), a ban on delivery of steers that are older than 30 months of age, and use of the 5-Area Weekly Weighted Average Direct Slaughter Cattle--Premiums and Discounts, to determine discounts and premiums applicable to deliveries.
- *Amendments to Speculative Position Limit Rules.* In FY 2004, several exchanges amended spot-month speculative position limit rules. For its wheat contracts, the CBOT eliminated the special spot month speculative limits during the last five trading days of the March and May contract months (which were 350 contracts for March and 220 contracts for May) and

adopted a scale down speculative position limit provision for the May contract so that the limit is based on the CBOT's Stocks of Grain Report on the Friday preceding the first notice day. At the request of Commission staff based on its review of NYMEX's certification filings, NYMEX amended its spot month speculative position limits for its natural gas basis swap futures contracts, to ensure that the limits comply with Commission policy and are appropriate to deter potential manipulation.

Intermediary Policy

- *Part 30 Rule Clarification*. On August 12, 2004, the Commission published in the *Federal Register* amendments to Part 30 to clarify when foreign futures and options brokers (FFOBs) who are members of a foreign board of trade must register or obtain an exemption from registration. The Commission amended Rule 30.4(a) to clarify that an FFOB is not required to register as an FCM pursuant to Rule 30.4, or to seek exemption pursuant to Rule 30.10, if it carries: 1) customer omnibus accounts for U.S. FCMs; 2) accounts proprietary to a U.S. FCM; and/or 3) U.S. affiliate accounts that are proprietary to the FFOB. In addition, an FFOB that has U.S. bank branches would be eligible for a Rule 30.10 comparability exemption or exemption from registration under Rule 30.4, based upon compliance with conditions specified in Rule 30.10(b)(1)-(6).
- *Draft Notice of Proposed Rulemaking Relating to Commodity Trading Advisors*. Commission staff are developing a notice of proposed rulemaking that would, if adopted, amend various of the Commission's rules relating to commodity trading advisors (CTAs). The first proposal would add to the Commission's rules a definition of the term "client" of a CTA. The second proposal would specify situations in which the registration exemption for CTAs providing standardized trading advice would not be available to an IB, or an associated person of an IB, or an FCM that manages client accounts pursuant to a letter of direction or other written authorization. This latter proposal would further specify situations in which a person managing client accounts pursuant to a letter of direction or other written authorization would be an account controller for the purposes of receiving account statements and other documentation.
- *Risk-Based Capital*. In August 2004, the Commission published in the *Federal Register* rule amendments that modernize regulatory minimum capital requirements for FCMs. Under the rule amendments, an FCM's minimum capital requirement is no longer based on a percentage of customer funds held by the FCM, but rather on specified percentages of the risk maintenance margin requirements for all positions the FCM holds for customers and certain affiliated entities and employees. The revised rules correlate a firm's capital requirement to the particular risks of the futures and options positions the firm carries, and are consistent with the risk-based capital requirements that several futures organizations have implemented previously for their member firms.
- *Staff Letter Clarifying CPO Registration Exemption*. In April 2004, Commission staff issued a letter clarifying application of the CPO exemption that was adopted in August 2003 as Rule 4.13(a)(3). The letter stated that a CPO claiming exemption under Rule 4.13(a)(3) may admit Non-U.S. persons (as defined in Rule 4.7) as participants in the CPO's pool without regard to whether such Non-U.S. persons meet the investor qualifications set forth in Rule 4.13(a)(3)(iii).

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- **CPO Registration Exemptions.** In light of the staff letter discussed above, in July 2004, the Commission adopted an amendment to Rule 4.13(a)(3). In August 2003, the Commission had adopted additional exemptions from CPO registration. Broadly stated, Rule 4.13(a)(3) provides a CPO registration exemption where: a pool's participants meet certain sophistication standards (e.g., all participants are accredited investors); and the pool's commodity interest trading is restricted as specified in the rule (e.g., the pool does not commit more than 5 percent of the liquidation value of its assets to establish its commodity interest trading positions). Rule 4.13(a)(4) provides a CPO registration exemption where a pool's participants meet (in the case of non-natural person U.S. entities) or exceed (in the case of natural persons) the sophistication standards of Rule 4.13(a)(3). Because of this higher sophistication standard, there is no trading restriction under this exemption. Accordingly, the amendment provides that, if a person can participate in a Rule 4.13(a)(4) pool, which has no trading restrictions, the person similarly may participate in a Rule 4.13(a)(3) pool, which does have a trading restriction, without requiring the operator of the pool to register as a CPO.
- **Comparability Relief for Australian Entities.** In June 2003, the Commission issued an order under Rule 30.10 granting the application for relief by the ASX Futures Exchange Proprietary Limited (ASXF), a subsidiary of the Australian Stock Exchange, on behalf of certain firms located and doing business in Australia. This relief permits those members to solicit and accept orders and funds related thereto from persons located in the U.S. for trades on the exchange without registering under the Act or complying with Commission rules based upon substituted compliance with applicable Australian law and ASXF rules. The staff was advised that, effective March 2004, the Australian Stock Exchange assumed the futures business of ASXF itself. Because of this reorganization and changes in Australian law that may affect expanded relief (i.e., when Australian firms handle transactions on non-Australian markets), staff is preparing a revised Commission order to address the change in circumstances.
- **Revised U.K. Rule 30.10 Order.** On September 30, 2003, the Commission issued an order to the U.K. Financial Service Authority (FSA) consolidating and updating the relief set forth in prior orders issued pursuant to Commission Rule 30.10 regarding the offer and sale of foreign futures and options contracts to customers located in the U.S. by firms located in the U.K. This order reflects the substitution of the FSA for various U.K. regulatory and self-regulatory organizations (SROs). 68 Fed. Reg. 58583 (October 10, 2003). Among other changes to the terms and conditions for relief, the Commission exempted firms designated by the FSA from compliance with the Commission's risk disclosure requirements as they apply to transactions under Part 30 of the Commission's rules, and authorized such firms to permit U.S. customers that are eligible contract participants to opt out of segregation with respect to foreign futures and options transactions entered into pursuant to the revised order. The Commission's order also revised certain staff no-action letters regarding the treatment of customer funds attributable to trading on the London Metals Exchange.
- **Remote Clearing.** In a matter, commonly referred to as "remote clearing," a foreign firm whose customers are located outside of the U.S. requested to become a full clearing member of a combined designated contract market and derivatives clearing organization. Commission staff researched the legal question as to whether a foreign firm clearing for non-U.S. customers only would be required to register with the Commission as an FCM, and addressed the material policy issues of remote clearing with respect to both customer protection and the financial integrity of the markets. After discussions with staff, the foreign firm decided to apply for registration with the Commission

as an FCM. Staff currently is considering the issue of remote clearing and how it may relate to cross-border clearing arrangements.

Clearing and Intermediary Oversight

- *Development of New Oversight Examination Programs.* Similar to the approach of other federal financial regulators and certain overseas financial supervisors – indeed, in close consultation with several such peers – the Division has begun to enhance its supervision of exchanges, clearinghouses, and other self-regulatory organizations with risk-based examination cycles and risk-focused reviews. Both the scheduling and scope of the Division's supervisory reviews will now be based on careful analysis of the underlying risks to which an institution is exposed and the controls which it has in place to address those risks. This approach promises to better utilize supervisory resources and to help ensure even greater financial integrity and risk management within the firms and clearinghouses that are the backbone of the futures clearing system. The Major Reviews unit, one of two new units within the Division, was created during FY 2004 to plan, coordinate, schedule, monitor, and assess major risk-focused reviews. The unit's activities are intended to ensure that multiple, simultaneous major reviews are completed on schedule, follow appropriate benchmarks of consistency and comparability, and, ultimately, provide meaningful assessments of core principle compliance which, when presented formally to the Commission, permit the Commissioners to assure themselves that the Commission is fulfilling its responsibilities on this important aspect of market oversight.
- *SRO Oversight Review of the CME.* In December 2003, Commission staff completed a risk-based SRO oversight review of CME. The review covered five functional areas: financial capacity; customer protection; risk management; market move surveillance and stress testing; and operational capability. In addition to the five functional areas examined at CME, Commission staff directly examined four CME-member FCMs to independently corroborate CME's performance of its SRO responsibilities.
- *Modernizing and Streamlining Financial Filing Requirements.* In August 2004, the Commission published in the *Federal Register* rule amendments that modernize certain financial reporting requirements for IBs and FCMs. The amendments require FCMs, consistent with the monthly reporting requirements of various self-regulatory organizations, to submit financial statements to the Commission on a monthly rather than quarterly basis. The more frequent filing of financial statements is an integral component of the Commission's FCM financial surveillance program, which utilizes customer market position data to assess financial exposures to individual firms and to the clearing system. The Commission also amended its rules to permit IBs to file their required semiannual unaudited reports, and also their certified annual financial reports, solely with NFA. The amendments streamline the regulatory reporting requirements for IBs, and the Commission will continue to have access to IB financial statement information through NFA.
- *Oversight Review of NFA's Program for Supervision of CPOs and CTAs.* During FY 2004, Division staff developed a revised program for review of NFA's supervision of CPOs and CTAs. The review program will focus on all aspects of NFA's supervision of CPOs and CTAs, including: registration of CPOs and CTAs; collection and processing of disclosure documents, financial reports, and exemption notices filed by CPOs and CTAs; compliance examinations of CPOs and CTAs; and supervision of sales practices utilized by CPOs and CTAs.

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- *Revision of Form 1-FR-FCM and Instruction Manual.* In August 2004, the Commission approved amendments to financial Form 1-FR-FCM to reflect the new risk-based capital rules. An FCM is required to file a Form 1-FR-FCM with the Commission and with the firm's designated self-regulatory organization on a monthly basis. The Commission also approved amendments to an instruction manual for the Form 1-FR-FCM. The amendments not only incorporate the changes necessitated by the adoption of a risk-based capital rule, but also reflect necessary changes resulting from numerous rulemakings and interpretations that have been issued by the Commission. The amendments reflect the first time that the instruction manual has been revised since it was first issued by the Commission in 1989.
- *Web-based Electronic Financial Filing for Introducing Brokers.* In June 2004, the Commission approved NFA rules to implement a new web-based electronic filing system (EasyFile) for IBs to file financial statements with NFA. Prior to the implementation of EasyFile, IBs filed their financial statements with NFA using the WinJammer electronic filing system, which also is used by FCMs. The EasyFile system was developed by NFA to address difficulties that some IBs had experienced with the WinJammer system. EasyFile provides IBs with a simpler electronic filing process, and was effective for unaudited financial statements dated June 30, 2004 or later.
- *CTA Past Performance Presentation.* In January 2004, the Commission reviewed and permitted to go into effect rules submitted by NFA regarding presentation of CTAs past performance information. NFA Compliance Rule 2-34 contains specific requirements for CTAs regarding the calculation, documentation and disclosure of the performance of partially funded client accounts to prospective clients. The rule requires CTA members to calculate rates of return and drawdown figures based upon nominal account size, as opposed to actual account size; specifies the terms of written confirmation for partially funded accounts; and sets forth certain additional disclosures that must be provided concerning the impact of partial funding. NFA also adopted an Interpretive Notice that provides guidance on each aspect of proposed Rule 2-34. In April 2004, the Commission approved amendments to NFA's Interpretive Notice to Compliance Rule 2-34. The amendments provide for use of an additional method of accounting for the impact of significant additions and withdrawals in the calculation of the rate of return information required to be included by Commission rules in the CTA's disclosure document. The Only Accounts Traded method permits exclusion from the rate of return calculation of accounts that meet specified criteria, on the basis that the program's composite rate of return would be distorted if the calculation included accounts that did not participate fully in the program, or had significant changes in their value during the period.
- *Acceptable Depositories for Customer Funds.* In August 2003, the Commission issued an interpretative letter to a large bank confirming that a trust account product developed by the bank was an acceptable deposit account for use by FCMs for the deposit of segregated customer funds. The Commission issued an additional interpretative letter in March 2004 to the bank confirming that the same trust account product was an acceptable deposit location for use by DCOs for the deposit of segregated customer funds. The additional interpretation was based on the continued applicability of the bank's analysis and representation that at all times funds deposited into the trust account would be available for withdrawal immediately upon demand.
- *SRO and DCO Oversight Review of MGE.* During FY 2004, Commission staff initiated a risk-based SRO and DCO oversight review of the MGE. A request for production of MGE documents has been made and Commission staff will soon review such documents and commence preliminary interviews.

The SRO portion of the examination will focus on five functional areas: financial capacity; customer protection; risk management; market surveillance and stress testing; and operational capability. The DCO portion will involve an assessment of MGE's continuing compliance with core principles for DCOs. Commission staff anticipates completion of the SRO and DCO oversight review in FY 2005.

- *Limited Reviews of FCMs with respect to Regulation 1.49 and 30.7.* In July 2004, Commission staff initiated a series of limited scope reviews of FCMs to determine how FCMs are implementing and complying with new Commission Regulation 1.49, which governs the deposit of customer-segregated funds in non-U.S. jurisdictions. Simultaneously, Commission staff initiated a series of limited scope reviews of FCMs to determine what types of investments were being made of funds required to be held in separate accounts for U.S.-domiciled customers trading on foreign futures and options markets. These results of these limited scope reviews will be assessed to determine if any additional rulemakings or Commission guidance is necessary to safeguard customer funds.
- *Joint Audit Committee Program Review.* In connection with the Commission's SRO study and review of the Joint Audit Committee (a committee of financial examination and compliance representatives of the various SROs known as the JAC), Commission staff initiated a comprehensive review of the examination programs used by JAC members in completing their periodic reviews of member FCMs. Changes to such examination programs are submitted to the Commission annually.
- *Implementation of Monitoring Program for AML Supervision.* The Major Reviews unit, one of two new units within the Division, was created during FY 2004 to, in addition to managing major risk-focused reviews of exchanges and clearinghouses, develop and review standards for the evaluation and audit of registrant compliance with anti-money laundering (AML) requirements applicable to FCMs, IBs, CPOs, and CTAs.
- *Creation of Dedicated Financial Surveillance Unit.* The Financial Surveillance unit, one of two new units within the Division of Clearing and Intermediary Oversight (DCIO), was created during FY 2004 to enhance and expand the DCIO's utilization of automated tools and systems. This new unit will use the automated tools and systems to gather, combine, and analyze information from monthly financial reports filed by FCMs, large trader position information, and other relevant market and financial information so as to provide ongoing surveillance of actual or potential financial risks facing firms and clearinghouses and to anticipate emerging problems that may pose systemic risks.
- *Implementation of AML Provisions of USA PATRIOT Act.* Staff worked jointly with representatives of other Commission programs on various aspects of a program to combat money laundering and terrorist financing. Specifically, staff worked with the U.S. Treasury Department in developing final suspicious activity reporting and customer identification rules applicable to FCMs and IBs. The suspicious activity reporting rule applies to transactions occurring after May 18, 2004. Staff also worked with Treasury in developing proposed AML program rules for CTAs, investment advisers (IAs), and unregistered investment companies. The final rules are currently in the developmental stage. Staff also worked with the SEC and other agencies in drafting staff interpretations of the customer identification and verification rules and a proposed no-action position concerning the customers of certain CTAs and IAs. The first tier of the interpretations was issued on June 14, 2004.

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Staff also continues to work with Treasury in a process for sharing information about possible terrorists and money launderers. As part of this process, Commission staff maintains and updates a list of FCMs and contact persons, which Treasury then uses when issuing a list of possible money launderers and terrorists on a biweekly basis.

- *Business Continuity and Disaster Recovery Plan.* The Commission continued to address Business Continuity and Disaster Recovery (BC/DR) issues internally through development and refinement of internal business continuity plans, and with the futures industry through obtaining and reviewing current information on BC/DR plans at clearinghouses and exchanges, through encouraging and participating in industry-wide testing, and through encouraging and reviewing relevant rules SROs establish requiring their members to establish BC/DR plans. Such efforts were performed in concert with other Federal financial regulators working on an ongoing basis with the Financial and Banking Information Infrastructure Committee, and in particular, contributing to and assisting in the development of financial sector-wide vulnerability assessments.
- *Foreign Currency.* Commission staff continues to work with NFA staff regarding retail off-exchange foreign currency trading through FCMs and their affiliates. Commission staff has discussed this issue internally and has responded to numerous telephone and email inquiries. NFA submitted further rules in this area concerning required customer security deposits on May 24, 2004. The Commission allowed the rules to become effective without formal review under the "10-day process." Commission staff is currently working on an advisory to provide additional formal guidance regarding compliance and registration issues pertaining to entities involved in off-exchange retail foreign currency trading. Commission staff has also discussed with NFA issues concerning NFA audits and required adjusted net capital for firms engaged in retail foreign currency transactions.
- *CPO Disclosure.* In December 2003, the Commission permitted NFA, under the "10-day" provision, without Commission review, to repeal two rules related to CPO disclosure. One rule permitted CPOs to solicit accredited investors with a notice of intended offering and statement of terms, and the other permitted solicitation of any prospective participant with a profile document, rather than a Disclosure Document. CFTC amendments to its rules lifting the ban on CPO and CTA advertising made NFA's rules unnecessary.
- *Registration Procedures.* In March 2004, the Commission approved two NFA rules concerning registration. The first permits an interim oral hearing in a disqualification case to determine whether a failure to disclose derogatory information was willful. The other prohibits firms from sponsoring conditional registrants if the firms' *principals* (rather than just the firms themselves) are subject to a pending NFA proceeding alleging failure to supervise or fraud.
- *Foreign Firms.* In December 2003, the Commission permitted NFA, under the "10-day" provision, without Commission review, to make several rule amendments concerning foreign firms. The rule amendments included: 1) requiring foreign firms exempt from registration under Part 30 of the Commission's rules to pay the same \$100 annual records maintenance fee as registrants; 2) termination of the registration exemption of a foreign firm 30 days after it terminates its agreement designating a U.S. agent for service of process; 3) requiring foreign firms applying for FCM registration to make their books and records available in the U.S. on 24 hours notice, rather than the previous requirement allowing 72 hours; and 4) requiring foreign firms

applying for registration to provide records of examination reports and disciplinary actions issued by foreign regulators.

- *Arbitration Rules.* In December 2003, the Commission permitted NFA, under the "10-day" provision, without Commission review, to make several technical amendments to its member arbitration rules. These amendments included: requiring a counterclaim to be filed within two years or in a timely filed answer, whichever comes later; and allowing a party 35 days (up from 20 days) to file a reply to a counterclaim or cross-claim if the aggregate claim amount exceeds \$50,000.
- *Security Futures Products (SFP) Proficiency Examination.* In December 2003, the Commission determined, under the "10-day process", not to review NFA's proposal to amend the interpretive notice entitled Concerning Proficiency Requirements for SFPs, which indefinitely postpones updating the Series 3 and Series 30 examinations to include questions on SFPs. NFA had anticipated changing the exams by January 2004, but the low volume of SFP trading has resulted in a small number of persons interested in qualifying to engage in SFP activities. Commission staff has discussed with industry representatives expansion of the general proficiency examinations for associated persons of futures firms (Series 3) and registered representatives of securities firms (Series 7) to include questions concerning SFPs. Staff has discussed with the National Association of Securities Dealers, Inc. ways to address delays in, and possible SRO reluctance concerning, revision of the Series 7 examination to include questions about SFPs. An extra day of testing may be necessitated for an expanded Series 7 examination that includes SFP questions, but deletes no existing topic areas, or a separate examination focused solely upon SFPs. Staff also discussed this matter with SEC staff on May 28, 2003. For the time being, salespersons will be permitted to offer SFPs following the taking of a Web-based training module.
- *Dues and Fee Reductions.* In July 2004, amendments to NFA Bylaw 1301(b)(ii) and (d) became effective under the "10-day" procedure without Commission review. These amendments reduced membership dues by 25 percent, such that dues for FCMs for which NFA is the designated self-regulatory organization were reduced from \$7,500 to \$5,625 (the reduction is from \$2,000 to \$1,500 for all other FCMs) and dues for other member firms (IBs, CPOs and CTAs) were reduced from \$1,000 to \$750. NFA also amended Bylaw 1301(b)(i), effective January 2005, to reduce the assessment fees charged to FCM members for customer trades from \$.06 to \$.04 per round-turn for futures contracts and from \$.03 to \$.02 for option contracts.

Clearing Policy

- *Proposal of The Clearing Corporation to Clear Eurex Transactions.* In October 2004, the Commission issued an order approving a request from The Clearing Corporation, a DCO, to permit U.S. customers to clear, through clearing members of The Clearing Corporation, futures and options contracts traded on Eurex Frankfurt AG based on the German Bund, BOBL and SCHATZ, as well as on the DAX and Dow Jones Euro STOXX 50. The Clearing Corporation and participating FCMs are permitted to establish and maintain combined original margin and variation settlement accounts for both U.S. dollar-denominated contracts traded on Eurex US and Euro-denominated futures and options contracts traded on Eurex Frankfurt AG. Absent CFTC action, such commingling of customer assets supporting positions on a U.S. contract market with those executed on an overseas derivatives market would be prohibited by section 4d of the CEA.

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- *CME/CBOT Common Clearing Link*. In April of 2003, the CBOT entered into an arrangement to clear contracts through the CME. Commission staff studied and resolved the policy and legal issues raised by the link and its implementation in order to ensure orderly implementation of the arrangement, legal certainty, financial integrity, and customer protection in the futures markets. On October 9, 2003, the Commission approved CBOT's application for registration as a DCO. The link was successfully implemented in two phases, in November and December 2003. Commission staff closely monitored the transition. The link has provided efficiencies both in processing transactions and in utilization of capital. This arrangement furthers the CFMA's goal of supporting innovation in the futures industry.
- *London Clearing House*. On May 11, 2004, the Commission approved a request to amend its order registering the London Clearing House (LCH) as a DCO to permit LCH to clear contracts traded on U.S. contract markets. The Commission order addresses, among other things, the treatment of customer funds and bankruptcy issues. LCH was the first foreign entity to obtain registration as a DCO and the first foreign entity to be permitted to clear on behalf of U.S. exchanges.
- *BOTCC/CCorp Reorganization*. In October 2003, the former Board of Trade Clearing Corporation (BOTCC) restructured, recapitalized, and renamed itself the CCorp. The Commission reviewed the implementing rules and issued a letter addressing net capital implications for clearing members.
- *NYMEX Over-the-Counter (OTC) Option Clearing*. On February 10, 2004, the Commission issued an order permitting NYMEX and its clearing members to carry certain OTC options positions and associated margin deposits in customer-segregated accounts. The order was conditioned on a number of conditions, including the requirement that NYMEX maintain permanent customer protection mechanisms of not less than \$10 million to promptly reimburse retail customers in the event of certain defaults.
- *HedgeStreet*. On February 18, 2004, the Commission designated HedgeStreet as a DCM and a DCO. HedgeStreet operates and clears a market for certain unique products. On December 1, 2004, the Commission issued a revised order permitting HedgeStreet to clear fully collateralized positions.
- *Investment of Customer Funds*. On February 10, 2004, the Commission amended its rules to further expand the range of permissible investments by FCMs and clearinghouses of their customers' funds and property, which will now be permitted to enter into repurchase agreements and collateral management programs using customer deposited securities. The Commission expects to propose additional amendments that are designed to provide increased opportunities for enhancing yield while maintaining safeguards for the preservation of principal.
- *Multilateral Clearing Organization*. DCIO staff has participated in discussions with representatives of a Canadian-based electronic trading system for the trading, clearance and settlement of crude oil and condensate physical futures contracts and related swap contracts, regarding its plans to request relief pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). Section 409 of FDICIA provides that a multilateral clearing organization (MCO) for over-the-counter derivative instruments may operate in the U.S. without registering with the Commission as a derivatives clearing organization if, among other alternatives, the MCO is supervised by a foreign financial regulator that the Commission, or one of several other U.S. financial regulators, has determined satisfies appropriate standards. DCIO staff has opened a dialogue with the appropriate Canadian

regulator regarding its supervision of this entity. The Commission previously issued an order on January 11, 2002, granting similar relief to NOS Clearing ASA, a Norwegian clearing organization that clears and settles trades on the International Maritime Exchange, an electronic trading facility for cash-settled futures contracts for the transportation of maritime freight.

- *Options Clearing Corporation (OCC) Internal Cross Margining.* On November 5, 2004, the Commission issued an order permitting cross margining between certain securities products and certain futures products cleared by the OCC.

Market Compliance

The Commission's Market Compliance program oversees the compliance activities of all exchanges in furtherance of the Commission's primary goals of ensuring customer protection and market integrity. The oversight program consists of, among other things, periodic examinations of exchange self-regulatory programs to assess continuing compliance with applicable core principles under the Act and the Commission's regulations. In FY 2004, three reviews of exchange compliance programs were completed:

- *CSCE Rule Enforcement Review.* In May 2004, Commission staff issued a rule enforcement review of the CSCE that covered the period of June 1, 2002, through June 1, 2003. The review evaluated CSCE's audit trail, trade practice surveillance, disciplinary, and dispute resolution programs for compliance with relevant core principles. In its review, Division of Market Overview (DMO) staff found that CSCE maintains adequate programs with respect to the areas reviewed. However, staff identified one aspect of CSCE's trade practice surveillance program, its procedures for monitoring compliance with its cross-trade rules that should be enhanced. Staff recommended that CSCE increase the number of large-size cross trades it reviews for compliance with CSCE rules, develop procedures to identify and examine brokers who execute a large number of small-size cross trades in liquid contract months, and develop an automated exception report to assist in the surveillance of cross trades.
- *NYMEX Rule Enforcement Review.* In September 2004, Commission staff issued a rule enforcement review of the NYMEX that covered the period January 1, 2003, to January 1, 2004. The review evaluated NYMEX's audit trail, trade practice surveillance, disciplinary and dispute resolution programs for compliance with relevant core principles. In its review, DMO staff found that NYMEX maintains adequate self-regulatory programs in the areas reviewed. DMO also found that the exchange should further improve its compliance program by modifying its procedures for reviewing member compliance with record-keeping requirements and ensuring that disciplinary committees give greater deference to compliance staff's recommended sanctions.
- *MGE Rule Enforcement Review.* In September 2004, Commission staff issued a rule enforcement review of the MGE that covered the period December 1, 2002, to December 1, 2003. The review evaluated MGE's audit trail, trade practice surveillance, market surveillance, disciplinary and dispute resolution programs for compliance with relevant core principles. In its review, DMO staff found that the exchange maintains adequate self-regulatory programs in the areas reviewed. However, DMO recommended that the exchange further strengthen its procedures by ensuring that investigations are expanded, where appropriate, and that disciplinary matters are considered promptly.

Market Surveillance

The mission of the Commission's market surveillance program is to detect and prevent price manipulation. To accomplish this goal, surveillance economists continuously monitor all active futures and option contracts for potential problems. In FY 2004, the Commission conducted intensified surveillance in these markets:

- *Energy Futures Markets.* Crude oil, heating oil, and gasoline prices exhibited great volatility and reached record highs during FY 2004. Natural gas prices rose sharply in December 2003 and remained high. These markets were affected by geopolitical tensions and actual and potential threats to Middle East crude oil supplies, low domestic stocks, and economic growth leading to increased demand, constraints on domestic refining capacity, refinery disruptions, and changes in environmental requirements for gasoline. A number of expirations were closely watched and sharp price moves were analyzed. Trading activity in the natural gas futures market during December 2003 was analyzed in considerable detail.
- *Livestock/Meat Markets.* The discovery of a cow with BSE in Washington State in December 2003 resulted in a cutoff of U.S. exports of cattle and beef and a sharp downward price move in those products. By early summer 2004, prices had fully recovered, but were being buffeted by news and rumors of the potential lifting of the ban on Canadian cattle and beef, of the possible re-opening of export markets, and of the results from USDA program for enhanced testing of cattle for BSE. In a follow-up to a feeder cattle expiration, staff conducted an extensive inquiry. Frozen pork belly prices hit record-high levels as stocks hit record-low levels.
- *Soybean Market.* Lower than anticipated soybean production in both the U.S. and South America, coupled with unexpectedly large Chinese imports, led to a USDA forecast for the smallest U.S. ending stocks since 1977. The expectations of limited supplies resulted in soybean prices trading above \$10, their highest levels since 1988, and greater volatility than had occurred in the past 20 years.
- *Dairy Futures Markets.* Some dairy prices hit record price levels during the year and have been volatile, with record futures volume and open interest. This has been a result of milk production lower than year-ago levels, a ban on dairy cattle imports from Canada due to BSE, a decrease in production of a hormone that induces greater milk production from cows, and low-carb diets, which have increased demand for some dairy products.

Chief Economist

During FY 2004, the OCE (Office of Chief Economist) provided technical support to the Division of Enforcement on a number of cases regarding alleged fraud and manipulation in energy and foreign exchange markets. In addition, the staff provided technical support to the DCIO staff on risk management and the regulation of commodity pools. OCE staff testified in several cases requiring expert information on the economic functions and uses of futures contracts.

Staff from OCE continued to provide economic input into the analysis of commodity market and Commission initiatives. Staff members participated in the development of policies concerning new derivative instruments and trading mechanisms in futures markets. OCE staff also examined the issues of transparency, liquidity, and alternative block trading rules in futures markets and initiated research concerning hedge fund use of futures markets.

OCE staff also examined economic issues relating to exchange-proposed amendments to existing futures and option contracts and to the designation of new futures contracts. For example, staff participated in the analysis and disposition of major revisions to the CFTC/Exchange system of speculative limits and in the analysis of several "event-type" contract proposals. The staff members continue research on risk-management issues related to designated clearing organizations and intermediaries, including alternative market-risk measurements, stress tests, and risk-based capital requirements.

Space Management

The Office of Executive Director (OED) manages the Commission's real estate portfolio of approximately 250,000 square feet of rental office space for its headquarters and four regional offices. During FY 2004, OED negotiated a lease agreement for additional office space in the Kansas City regional office.

Other Initiatives

- *Placement of Electronic Terminals in the U.S.* The Commission continued its policy, initiated in FY 1999, whereby the staff issues no-action letters in response to requests by foreign boards of trade to permit placement of electronic terminals in the U.S. without requiring designation as a contract market or registration as a derivatives transaction execution facility. In FY 2004, staff processed an April 24, 2004, request for no-action relief from the European Energy Exchange (EEX) and its operator, European Energy Exchange AG. EEX, located in Leipzig, Germany, provides for the trading and clearing of energy forwards and energy derivatives contracts on a trading system that is identical to the Eurex trading system. Staff also considered a request from the Winnipeg Commodity Exchange (WCE) to place its electronic trading terminals in the U.S. Additionally, staff considered a proposal of the Sydney Futures Exchange (SFE) to expand its existing foreign terminal relief. SFE has requested that non-clearing SFE members be permitted to place terminals with U.S. customers, on the condition that the non-clearing members give up any resultant transactions to a guaranteeing FCM or Rule 30.10 firm. Finally, staff considered amendments to the foreign terminal no-action letters issued to Eurex Deutschland and Eurex Zurich to permit certain contracts executed on those exchanges to be cleared at The Clearing Corporation, as a special clearing member of Eurex Clearing AG.
- *Foreign Stock Index Offerings in the U.S.* Commission staff issues no-action relief for foreign boards of trade wishing to offer and sell stock index futures contracts in the U.S. During FY 2004, Commission staff completed economic analyses in support of the issuance of no-action letters for six such index contracts: the Taiwan Futures Exchange's Taiwan Stock Exchange Capitalization Weighted Index; the LIFFE's FTSEurofirst 80 Index and FTSEurofirst 100 Index; the National Stock Exchange of India's S&P Nifty; the SGX-DT's S&P Nifty; and Borsa Italiana's S&P/MIB Index futures contracts.
- *Block Trading and Other Off-Centralized-Market Trades.* On July 1, 2004, the Commission published a proposal to update its regulations governing trades that are transacted off the centralized market, in light of the CFMA. The proposal also would provide guidance to exchanges in adopting rules that permit block trading and other transactions executed off the centralized market.

Information Technology

Security and Continuity of Operations. In FY 2004, one of the Commission's primary focus areas for information technology was maintaining a secure envi-

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ronment that protects the Commission's information resources. To that end, the Commission developed policies and procedures that reduced the Commission's vulnerability to external cyber attacks. The Commission also continued to make significant progress in addressing high-priority deficiencies identified in a FY 2002 security program assessment and a FY 2003 Security Test and Evaluation of its General Support Systems.

Project eLaw. In FY 2004, the Commission began work on Project eLaw, an effort that will provide law office automation and modernization to the Commission Division of Enforcement, Office of the General Counsel, and Office of Proceedings. Project eLaw is a Commission-wide initiative that seamlessly integrates technology and work processes to support managers and staff across the Commission in their investigative, trial, and appellate work. Detailed planning and careful execution of Project eLaw tasks required extensive collaboration across the Commission to ensure all internal stakeholders had an opportunity to articulate their needs in this effort. In FY 2004, the requirements analysis, technology assessment, security plan and business impact analysis study were completed.

Integrated Surveillance System. In FY 2004, the Commission's primary mission critical application to support futures and option data market surveillance, the Integrated Surveillance System, was significantly enhanced to address changes and growth in the futures industry. Those changes included accepting markedly different contract markets that are traded on a new exchange, HedgeStreet, and daily futures now being traded on the Chicago Mercantile Exchange. In addition, significant effort to improve the capability and availability of the Integrated Surveillance System was executed through the implementation of over 12,000 system modifications and the implementation of a second data collection point for transmitted surveillance data.

Exchange Database System. During FY 2004, the Commission continued to improve the data collection technology and processes used by the Exchange Database System to provide a more efficient means of exchange data collection, resulting in more effective support for the Commission's market oversight objectives. We now receive almost all trade data submissions electronically on a weekly basis. The Exchange Database System also was enhanced to capture data from new electronic trading markets. The number of markets is expanding rapidly and the volume of trade data is significantly greater than the open outcry markets. To address this change we are working with the exchanges to establish data submission requirements. We have expanded the data collected to enhance the Commission's ability to analyze market activities.

TRADE. In FY 2004, the Commission made significant progress in developing a strategy for developing the Exchange Database System replacement system, known as TRADE. During this past year, we hired a project manager, established the TRADE project team that includes members from the Division of Market Oversight and Division of Enforcement, and began the procurement process to obtain contract support.

SPARK. In FY 2004, the Commission implemented a new system, Stressing Positions at Risk (SPARK) that can analyze the financial positions of trading firms in relation to changing market conditions. This application was developed to perform analysis of existing market conditions and conduct "what if" analyses on future changes in support of financial oversight and risk analysis of the futures market.

Intranet. In FY 2004, the Commission implemented an enhanced design of its Intranet Web site, Open Interest. Open Interest is the Commission's primary management tool for sharing and exchanging internal information with staff. The Web site incorporates anew information architecture and a user-centric design

that makes information and resources readily accessible. The new Web site provides a framework for the Commission as it moves forward toward the implementation of new technologies, such as portal and content management systems, in an effort to streamline management of the information needs within the organization.

CFTC.gov. In FY 2004, the Commission continued efforts to improve the distribution, quality, and accessibility of information and services to the general public through the Commission's Web site at: <<http://www.cftc.gov>>. Improvements in the design and usability of the Web site were made in the areas of *Equal Employment Opportunity*, *Careers at the Commission*, and *Press Office information*. In an effort to reach a wider audience, the Commission released its first Spanish language consumer protection advisory on commodity scams.

Enterprise Infrastructure. In FY 2004, the Commission strengthened and improved its enterprise infrastructure by 1) implementing redundant and load balancing Internet access, 2) employing enterprise network management and monitoring systems and 3) upgrading the Commission's wide area network (WAN). The Internet access improvements strengthen a vital tool the Commission utilizes during emergencies and daily operations and enhances Internet access performance, increasing staff efficiency. With the network management and monitoring capabilities, the Commission is proactively handling security incidents, trending and analyzing infrastructure growth requirements and addressing system failures. This proactive approach supports improved incident response time, better long-term planning and greater systems' availability and reliability. The WAN improvements resulted in better system performance and quality of service to the staff as they accomplish the Commission's mission.

In early FY 2004, the Commission's headquarters office completed a major physical restructuring and renovation of its office space. The final third of the headquarters staff was successfully relocated to remodeled space, moving all office furniture and computer equipment for each employee. This effort required significant effort for all of the administrative offices of the OED working under a very compressed schedule.

Management Operations

The Office of Management Operations has entered into a performance-based support services blanket purchasing agreement (BPA). The BPA has the ability to provide the Commission support service for mail, transportation, laborer, warehouseman, and help desk. Through issuing performance-based task orders under the agreement, we will ensure that required performance quality levels are achieved and that total payment is related to the degree that services performed or outcomes achieved meet contract standards. The Contractor will be given freedom to determine how to meet our performance objectives. Additionally, payment will only be made for services that meet the appropriate performance quality levels. As an added benefit, the Commission will be able to consolidate multiple current contracts into one, which will reduce administrative costs.

As part of the reengineering effort to redesign core business functions, transit subsidy, business cards, delegations of authority, and parking were transferred to the Office of Management Operations. Consolidation of these functions, with those of the Commission receptionist, has brought about greater efficiencies in servicing administrative needs for agency staff.

Major accomplishments during this fiscal year include the development of an Information Technology Disaster Recovery Plan, an agency-level Continuity of Operations Plan, a headquarters Occupant Emergency Plan, and program level Business Continuity Plans. Additional activities started this year and ongoing are

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implementation of the Disaster Recovery Plan, including build-out of the disaster recovery site, build-out of a Continuity of Operations Plan site, and enhancement of the Commission's information security awareness and training programs.

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Commission Strategies to Influence Outcomes

Modernizing and Streamlining Regulations and Orders

During FY 2004, Commission staff undertook initiatives to reduce regulatory burdens. For example:

- *Staff Letter Clarifying CPO Registration Exemption.* In April 2004, DCIO issued a letter clarifying application of the CPO registration exemption that was adopted in August 2003 as Rule 4.13(a)(3). The letter stated that a CPO claiming exemption under Rule 4.13(a)(3) may admit Non-U.S. persons (as defined in Rule 4.7) as participants in the CPO's pool without regard to whether such Non-U.S. persons meet the investor qualifications set forth in Rule 4.13(a)(3)(iii).
- *CPO Registration Exemptions.* In light of the staff letter discussed above, in July 2004, the Commission adopted an amendment to Rule 4.13(a)(3). In August 2003, the Commission had adopted additional exemptions from CPO registration. Broadly stated, Rule 4.13(a)(3) provides a CPO registration exemption where: (1) a pool's participants meet certain sophistication standards (e.g., all participants are accredited investors); and (2) the pool's commodity interest trading is restricted as specified in the rule (e.g., the pool does not commit more than 5 percent of the liquidation value of its assets to establish its commodity interest trading positions). Rule 4.13(a)(4) provides a CPO registration exemption where a pool's participants meet (in the case of non-natural person U.S. entities) or exceed (in the case of natural persons) the sophistication standards of Rule 4.13(a)(3). Because of this higher sophistication standard, there is no trading restriction under this exemption. Accordingly, the amendment provides that, if a person can participate in a Rule 4.13(a)(4) pool, which has no trading restrictions, the person similarly may participate in a Rule 4.13(a)(3) pool, which does have a trading restriction, without requiring the operator of the pool to register as a CPO.
- *SFP Proficiency Examination.* In December 2003, the Commission determined not to review NFA's proposal to amend the interpretive notice entitled Concerning Proficiency Requirements for SFPs, which indefinitely postpones updating the Series 3 and Series 30 examinations to include questions on SFPs. NFA had anticipated changing the exams by January 2004, but the low volume of SFP trading has resulted in a small number of persons interested in qualifying to engage in SFP activities. DCIO staff have discussed with industry representatives expansion of the general proficiency examinations for associated persons of futures firms (Series 3) and registered representatives of securities firms (Series 7) to include questions concerning SFPs. Staff have discussed with the National Association of Securities Dealers ways to address delays in, and possible SRO reluctance concerning, revision of the Series 7 examination to include questions about SFPs. An extra day of testing may be necessitated for an expanded Series 7 examination that includes SFP questions, but deletes no existing topic areas or a separate examination focused solely upon SFPs. Staff also discussed this matter with SEC staff on May 28, 2003. For the time being, salespersons will be permitted to offer SFPs following the taking of a Web-based training module.
- *Rule 30.10 Orders.* The Commission revised and consolidated various orders issued under Commission Rule 30.10 to U.K. regulatory and self-regulatory bodies in light of reorganization of the U.K. financial regulatory structure. In connection with this process, the Clearing and Intermediary Oversight pro-

gram issued letters to other recipients of Rule 30.10 orders, requesting that they advise of any material changes to the representations, facts, or circumstances upon which the Commission's order was based, including changes in the regulatory program; and submit an updated list of members and regulatees that have received confirmation of relief. Based upon the responses, Clearing and Intermediary Oversight program staff have determined that revisions to the orders are not necessary, except for the order issued to ASXF due to the assumption of its functions by the Australian Stock Exchange.

- *Part 30 Rule Clarification.* On August 12, 2004, the Commission published in the *Federal Register* amendments to Part 30 to clarify when FFOBs, who are members of a foreign board of trade must register or obtain an exemption from registration. The Commission amended Rule 30.4(a) to clarify that an FFOB is not required to register as an FCM pursuant to Rule 30.4, or to seek exemption pursuant to Rule 30.10, if it carries: 1) customer omnibus accounts for U.S. FCMs; 2) accounts proprietary to a U.S. FCM; and/or 3) U.S. affiliate accounts that are proprietary to the FFOB. In addition, an FFOB that has U.S. bank branches would be eligible for a Rule 30.10 comparability exemption or exemption from registration under Rule 30.4, based upon compliance with conditions specified in Rule 30.10(b)(1)-(6).
- *Investment of Customer Funds.* Commission staff continue to work with industry representatives to explore ways in which the rules governing investment of customer funds can be adjusted to provide flexibility while minimizing risk. A rulemaking is ongoing in this area.
- *Global Clearing Links.* Commission staff are working with DCOs in connection with innovative clearing proposals. An order was issued expanding LCH's authorization to permit it to clear for U.S. exchanges.

Trade Practice System

The Commission completed its evaluation of the Commission's aging automated trade practice surveillance system, and has concluded that the demands of today's futures marketplace require development and implementation of a new system. The trade practice surveillance system identifies possible trading abuses for referral to exchanges and the Division of Enforcement, supports Commission investigations and litigation involving manipulation and trade practice abuses, and is an important adjunct to Commission rule enforcement reviews of contract markets. A new, robust Commission trade practice surveillance system will allow identification of inter-exchange violations, which individual exchanges lack the capacity to detect, allow quicker access to and more sophisticated and customizable analysis of, the full range of data supplied by exchanges with respect to electronic, as well as open outcry trading, and enable meaningful Commission evaluation of the exchanges' own electronic surveillance systems. In designing and implementing the new trade practice surveillance system, to be called TRADE, Commission staff will combine custom-built components with available off-the-shelf software to give the Commission unqualified, immediate, and confidential access to all exchange-supplied data. TRADE will take approximately two and one-half years to implement fully, and will be rolled out incrementally. After completion, the new system will reduce ongoing annual maintenance costs as compared with the current system.

Electronic Trading Platforms

Markets regulated by the Commission have experienced a dramatic shift from floor to screen-based trading over the past several years. The CBOT's and CME's screen-based volume currently accounts for approximately 65 percent of total

exchange volume. While electronic trading brings certain regulatory benefits, like very precise audit trails, it also may increase the opportunity for certain types of abuses. In FY 2004, the Commission completed a review of the various effects the dramatic growth of electronic trading may have on market participants' ability to engage in trading abuses and the implications of that growth on the Commission's ability to monitor effectively those markets. The Commission examined the electronic trading systems and automated surveillance systems used by U.S.-designated contract markets, as well as those used by foreign futures exchanges with significantly more experience in electronic trading. The Commission also interviewed foreign regulatory officials with respect to their mechanisms for oversight of electronic markets. The Commission will incorporate the lessons learned from its review in its oversight program and ensure that its new TRADE system will have robust capabilities to identify potential violations that may occur in the electronic environment.

Electronic Filing and Record-keeping

In August 2004, the Commission approved final rule amendments that modernize certain financial reporting requirements for IBs and FCMs. The amendments include a requirement that FCMs, consistent with the monthly reporting requirements of various self-regulatory organizations, submit financial statements to the Commission on a monthly rather than quarterly basis. The more frequent filing of financial statements is an integral component of the Commission's FCM financial surveillance program, which utilizes customer market position data to assess financial exposures to individual firms and to the clearing system. The Commission also amended its rules to permit IBs to file their required semiannual unaudited reports, and also their certified annual financial reports, solely with NFA. The amendments streamline the regulatory reporting requirements for IBs, and the Commission will continue to have access to IB financial statement information through NFA.

In June 2004, the Commission approved NFA rules to implement a new Web-based electronic filing system (EasyFile) for IBs to file financial statements with NFA. Prior to the implementation of EasyFile, IBs filed their financial statements with NFA using the WinJammer electronic filing system, which also is used by FCMs. The EasyFile system was developed by NFA to address difficulties that some IBs had experienced with the WinJammer system. EasyFile provides IBs with a simpler electronic filing process, and was effective for unaudited financial statements dated June 30, 2004 or later.

Use of the Internet/Intranet

The Commission uses the Internet to make information and assistance available to the general public. The Commission's Web site, at <<http://www.cftc.gov>>, provides information about the Commission and its work, including press releases, speeches of Commissioners, the *Weekly Advisory* (which includes Commission events, meetings, news, seriatim actions, *Federal Register* notices and comment periods, initial decisions, and opinions and orders), the *Commitment of Trader Reports*, and other reports from the Market Oversight program, and the *Proceedings Bulletin*. The Commission's Web site also provides the public with information concerning trader sanctions, registration suspensions, and reparations. The Web site also hosts a public questionnaire that encourages the public to report suspected commodity market abuses.

In FY 2004, the Commission implemented an enhanced design of its Intranet Web site, Open Interest. Open Interest is the CFTC staff's primary tool for sharing and exchanging information. The Web site incorporates a new information architecture and a user-centric design that makes information and resources

readily accessible. The new Web site provides a framework for the Commission as it moves forward toward the implementation of new technologies, such as portal and content management systems, in an effort to streamline management of the information needs of the organization.

In FY 2005, the Commission will begin pre-implementation planning and requirements gathering to define the optimal strategy for deploying a content management system within the organization. As part of this process, activities will focus on taxonomy development, content governance, and process analysis. To support this effort in FY 2004, the Commission partnered with the General Services Administration, Office of Citizen Services and Communications to benefit from existing cross agency best practices and shared technology solutions.

In FY 2005, the Commission will begin an evaluation and assessment of its Internet Web site. The assessment will identify the information requirements of current and future users and provide recommendations for the structure, presentation, and labeling of information on the CFTC.gov Web site. The new Web site will incorporate the recommendations of the Federal Web Content Standards Working Group, established by the Interagency Committee on Government Information, as one part of the Commission's efforts to make its Web site and information more citizen-focused, visitor-friendly, and accessible.

Internet Surveillance

The Commission monitors the Internet for illegal activity involving commodity futures and options. Enforcement staff review the contents of futures and options related Web sites, e-mail spam, bulletin boards, and newsgroups to identify potential misconduct. This monitoring of the Internet generates enforcement inquiries concerning issues such as possible misrepresentations of the success of trading programs and the offer of potentially illegal products that are not traded on a trading facility designated or registered by the Commission. Commission enforcement actions often include allegations of violative conduct involving use of the Internet.

During approximately the first half of FY 2004, the Enforcement program's Internet Enforcement Group contracted with a vendor in order to increase the efficiency and effectiveness of its surveillance program. The contractor conducts automated searches of the Internet with results reported to the Enforcement program on a monthly basis. Since the end of this contract, the Internet Enforcement Group has used commercial software and publicly available search engines to bridge the gap until another vendor has been retained.

The success of the Internet Enforcement Group during FY 2004 is reflected, in part, by the 13 enforcement actions filed through the third quarter of 2004 that involved allegations of fraudulent Internet solicitations: *CFTC v. Matrix*, CFTC Docket No. 04-01 (CFTC filed Oct. 2, 2003); *CFTC v. Rowell*, CFTC Docket No. 04-02 (CFTC filed Oct. 15, 2003); *CFTC v. Bibas Levy Corp., et al.*, No. 03-22624 (S.D.Fla. Oct. 7, 2003); *CFTC v. Marquis Financial Mgt. Systems, Inc., et al.*, No. 03-74206 (E.D.Mich. filed Oct. 20, 2003); *CFTC v. Profit Partners, Inc.*, No. CV03-9190 (Dec. 16, 2003); *CFTC v. Emerald Worldwide Holding, Inc., et al.*, No. CV03-8339 AHM(Ex) (C.D.Cal. filed May 10, 2004); *In re Harrison*, CFTC Docket No. 04-04 (CFTC filed Nov. 18, 2003); *CFTC v. Clearview Capital Mgt., et al.*, No. 04cv45 (FSH) (D.N.J. filed Jan. 8, 2004); *CFTC v. Gibraltar Monetary Corp., et al.*, No. 04-80132 (S.D.Fla. filed Feb. 10, 2004); *CFTC v. E Net Speculation Ltd., et al.*, No. 3:04CV169-s (W.D.Ky. filed March 19, 2004); *CFTC v. Equity Financial Group LLC, et al.*, No. 04CV1512 (D.N.J. filed April 1, 2004); *CFTC v. Axess Trade Co., Inc.*, No. 04 CV 4293 (S.D.N.Y. filed June 7, 2004); and *CFTC v.*

Weatherford, No. CV04-4079 SJO(CWz) (C.D.Cal. filed June 8, 2004). Four of these actions are the direct result of the automated Internet surveillance contract.

Overall, the Internet Enforcement Group's activities have resulted in the opening of at least 26 enforcement inquiries or investigations in FY 2004.

Project E-Law

During FY 2004, the Enforcement program continued in its efforts to design and implement Project eLaw, an automated law office that seamlessly integrates technology and work processes to support managers and staff across the Commission in their investigative, trial, and appellate work. Driven by the Commission's continued reliance on manual processes and automated tracking systems to manage cases and the approximately one million paper documents received or created annually, Project eLaw will provide the automated tools to assist staff in performing their work more efficiently and effectively, both in the office and in the courtroom facing opposing counsel. Specifically, Project eLaw will enable staff to: 1) efficiently query and retrieve information about investigations and litigation provided to the Commission by outside parties; 2) develop documents in a collaborative electronic work environment across geographically dispersed locations; 3) improve management of investigation leads and trial schedules; 4) track time and resources expended on investigations and cases; and 5) access and present documentary and analytic evidence in court settings.

The Project eLaw is well underway and proceeding according to expectations. Contractor support was secured via a competitive procurement in September 2003. The initial task to document business requirements was finalized in March 2004. In addition, a technology assessment task to identify commercial-off-the-shelf software products to satisfy CFTC requirements has been completed and recommendations have been made in the areas of litigation support and case management tools.

The next task is a business impact analysis and a concept of operations study. The purpose of the business impact analysis is to assess the projected impact of eLaw on CFTC's operating environment. The business impact analysis phase builds on the functional requirements developed during the requirements analysis phase and addresses the business processes that will be supported by future eLaw capabilities. Additionally, the concept of operations study will identify the key roles required for the successful operation of the eLaw solution. Specifically, it will identify the staff skills and rolls required for continued operations, the individuals responsible for activities, and the frequencies of such activities. Following these efforts an overall implementation plan and schedule will be prepared. Pilot implementations occurred in the third and fourth quarters of FY 2004. Final implementation is planned for FY 2005.

Enforcement Training

During FY 2004, the Enforcement program continued to devote significant resources and time to develop and implement in-house training. The Enforcement program presented an in-house series of training lectures featuring Enforcement staff experts addressing areas of general and topical interest including: investigation and prosecution of forex fraud; substantial changes to the division's enforcement procedures; CTA solicitation fraud; the Freedom of Information Act (FOIA); electronic trading platforms; and techniques for detecting futures violations on the Internet.

The Enforcement program also took advantage of training offered by other entities. For example, the NFA presented an intensive training program focused on the futures and options industry and also provided training on the investigative

use of the NFA's registration databases. Treasury's Financial Crimes Enforcement Network trained Enforcement program investigators in tracing funds and investigation of money laundering. Also, a U.S. Attorney's Office shared with the Enforcement program insights into their investigation and prosecution of criminal fraud.

Academic Papers

During FY 2004, staff published or presented papers on topics relating to price discovery, hedging and risk aversion, the theory of storage, electronic versus open outcry trading, and factors affecting derivatives market success or failure. Papers were accepted for publication or published in academic journals such as *The Journal of Finance*, *The Journal of Business*, *The Journal of Futures Markets* and *The Southern Economic Journal*. Research on similar topics concerning the microstructure and uses of futures and option markets is planned for FY 2005 and 2006.

Opinions Process

During FY 2004, OGC continued to make significant progress in reviewing opinions matters and preparing draft decisions for the Commission. Several cases involving "hedge-to-arrive" instruments were completed during the year, and a number of cases addressing the imposition of civil monetary penalties were resolved. The process has become increasingly streamlined, as closer collaboration with staff of the Commissioners' offices has replaced interim written products. In addition, the staffing level of the Opinions program has increased. In consequence, OGC anticipates that the number and average age of pending cases will continue to decline.

Expediting Fitness Information Sharing

The Office of International Affairs has helped the NFA develop its "International Regulators' Alert System" to keep international regulators informed about U.S. firms operating in their jurisdictions. This system uses information from NFA's Background Affiliation Status Information Center (BASIC) to provide publicly available background and disciplinary information to foreign regulators. The system also can be programmed to provide ongoing alerts to enhance information sharing. When a regulator initially requests information on a firm, they receive registration status, registration history, and disciplinary information on the firm and its principals. From that point forward, any regulatory information about that firm that is entered into BASIC by NFA, the Commission, or an exchange, will trigger an immediate regulatory alert e-mail. Regulators are also immediately notified when a firm withdraws from the industry or is terminated. Increased use of this system by foreign regulators will expedite information sharing and lessen a paperwork burden on Commission staff. Because receipt of such fitness information is typically required by foreign regulators in order to authorize the placement of U.S. exchanges' electronic trading systems in foreign countries, the availability of this system supports market access by U.S. markets. The countries currently using this system include: Canada (Ontario and the Investment Dealers Association), France, Germany, Italy, Taiwan, Singapore, and South Africa.

Automated Access to Research Information

The Commission provides its employees with automated research tools that make information readily accessible at their desktops and provide faster and more efficient search and retrieval capabilities. The Commission Library installed a Windows-based integrated library system, Horizon, which enhances employee access to library materials. All catalog records have been successfully transferred from the previous system and all new borrower records have been included in Horizon.

Presently, the system is available only on terminals in the Commission Library. The Commission Library is working to make the system available to all Commission employees at their desktops during calendar year 2005.

The Library contracted with Lexis to convert the printed versions of the Commission's legislative history, as well as all relevant legislative history pertaining to futures trading, into a full-text searchable database. This database will significantly enhance productivity and allow Commission attorneys to conduct more sophisticated searches. The project will be completed during calendar year 2005.

Information Technology Improvements

In FY 2004, the Commission's primary mission critical application to support futures and option data market surveillance, the Integrated Surveillance System (ISS), significantly enhanced to address changes and growth in the futures industry. Those changes included accepting markedly different contract markets that are traded on a new exchange, HedgeStreet, and daily futures now being traded on the CME. In addition, significant effort to improve the capability and availability of the Integrated Surveillance System was executed through the implementation of over 12,000 system modifications and the implementation of a second data collection point for transmitted surveillance data.

In FY 2005, the Commission will continue to refine the Integrated Surveillance System to further automate requirements of the CFMA, such as the oversight of ECMs. Accordingly, the Commission will design and develop new Integrated Surveillance System software systems to efficiently and effectively capture, store, and analyze ECMs' trade data. In addition, Integrated Surveillance System will upgrade its internal processing to more efficiently and effectively load and edit surveillance data.

During FY 2004, the Commission continued to improve the data collection technology and processes used by the Exchange Database System to provide a more efficient means of exchange data collection, resulting in more effective support for the Commission's market oversight objectives. We now receive almost all trade data submissions electronically on a weekly basis. The Exchange Database System also was enhanced to capture data from new electronic trading markets. The number of markets is expanding rapidly and the volume of trade data is significantly greater than the open outcry markets. To address this change we are working with the exchanges to establish data submission requirements. We have expanded the data collected to enhance the Commission's ability to analyze market activities.

In FY 2005, the Commission will continue to enhance the Exchange Database System by capturing data from new electronic trading markets. This effort will enable the Commission to strengthen its market oversight activities and prepare for the creation of the new Exchange Database System replacement system TRADE. The Exchange Database System will also continue to operate to support the Commission market oversight mission for all existing futures markets.

In FY 2004, the Commission made significant progress in developing a strategy for developing the Exchange Database System replacement system, known as TRADE. During this past year, we hired a project manager, established the TRADE project team that includes members from the Division of Market Oversight and Division of Enforcement, and began the procurement process to obtain contract support.

After the contract award in FY 2005, the Commission will gather requirements for TRADE, conduct a technical assessment, and develop the TRADE technical

architecture, data architecture, and system design.

In FY 2004, the Commission implemented a new system, SPARK that can analyze the financial positions of trading firms in relation to changing market conditions. This application was developed to perform analysis of existing market conditions and conduct "what if" analyses on future changes in support of financial oversight and risk analysis of the futures market.

In FY 2005, the Commission will upgrade the SPARK system to increase financial analysis capabilities and expand the scope of analysis to incorporate clearing members data.

In FY 2004, the Commission began work on Project eLaw, an effort that provides law office automation and modernization to the Commission Division of Enforcement, Office of the General Counsel, and Office of Proceedings. Project eLaw is a Commission-wide initiative that seamlessly integrates technology and work processes to support managers and staff across the Commission in their investigative, trial, and appellate work. Detailed planning and careful execution of Project eLaw tasks required extensive collaboration across the Commission to ensure all internal stakeholders had an opportunity to articulate their needs in this effort. In FY 2004, the requirements analysis, technology assessment, security plan, and business impact analysis study were completed.

In FY 2005, the Commission will begin the Project eLaw system implementation. The eLaw solution, a set of commercial-off-the-shelf products, will support the Commission's legal practice in the areas of: case planning, case management, litigation support, and document management. The implementation of each product will be initially piloted in FY 2005.

In FY 2004, the Commission strengthened and improved its enterprise infrastructure by: 1) implementing redundant and load balancing Internet access, 2) employing enterprise network management and monitoring systems, and 3) upgrading the Commission's WAN. The Internet access improvements strengthen a vital tool the Commission utilizes during emergencies and daily operations and enhances Internet access performance, increasing staff efficiency. With the network management and monitoring capabilities, the Commission is proactively handling security incidents, trending and analyzing infrastructure growth requirements, and addressing system failures. This proactive approach supports improved incident response time, better long-term planning and greater systems' availability, and reliability. The WAN improvements resulted in better system performance and quality of service to the staff as they accomplish the Commission's mission.

In FY 2005, the Commission will also: 1) enhance the Commission's videoconferencing capability; 2) continue to reengineer its information resource management processes; 3) implement a new enterprise backup solution; and 4) enhance its disaster recovery capabilities.

Information Technology Security Improvements

In FY 2004, one of the Commission's primary focus areas for information technology was maintaining a secure environment that adequately protects the Commission's information resources. To that end, the Commission developed policies and procedures that reduced the Commission's vulnerability to external cyber attacks. The Commission also continued to make significant progress in addressing high-priority deficiencies identified in a FY 2002 security program assessment and a FY 2003 Security Test and Evaluation of its General Support Systems.

In FY 2005, the Commission will continue to address high-priority deficiencies identified in an FY 2002 security program assessment. Primary activities planned for FY 2005 include: 1) the certification and accreditation of the Commission's general support system and major applications, 2) exercising test plans for the use of the Commission's disaster recovery and continuity of operations sites, 3) testing the Commission's program-level business continuity plans, 4) expansion of the audit and evaluation component of the Commission's security program, and 5) development and implementation of an information security performance measurement process.

Enhanced Management Strategies

The internal review of the structure and functions of the Office of Management Operations, which was started in FY 2002 and completed in FY 2003, has led to significant improvements in critical administrative service areas in FY 2003. The progress to date includes: 1) development and implementation of a new automated supply ordering system; 2) review of the Commission's transportation service standards; and 3) relocation for enhanced functionality and security the functions of the main reception center, the mailroom and the administrative help desk.

During FY 2004, the OED continued its work to improve financial management through its efforts to align the Management Accounting Code System (MASC), the organization of the payroll system, and the budget structure in the financial management system to enable full integration of performance measurement and financial reporting as required by the Accountability for Tax Dollars Act of 2002 and the President's Management Agenda (PMA).

The OED collaborated with several entities to implement the provisions of the Farm Security and Rural Investment Act of 2002 to bring the Commission's pay system in line with those of other Federal financial regulators. This included working with the Commission's Executive Management Council (EMC) and an expert consultant to develop the new system of pay and benefits as well as working with the National Finance Center, the Commission's payroll service provider, to reprogram the payroll system with the new salary rates. OED also created a secure Web-based, interactive database, the CFTC Emergency Contact Database System, to be maintained to enable prompt response in the event of an emergency affecting the operations of one or more Commission regional offices or the personal well being of one or more employees.

Improved Access to Human Resources Information

The Commission continues to design, test, and implement government-wide and Commission-wide human resource systems that will provide efficient and effective access to human resources information to its employees and managers, including:

- Established the Human Capital Committee of the EMC. Building on the successful model of the project undertaken by the entire EMC to design the initial CT system of pay and benefits, establishment of this committee will allow efficient development of recommendations on future options to enhance recruitment and retention of mission-critical human capital using the pay and benefits authority of the section 10702 of Public Law 107-171, the Farm Security and Rural Investment Act of 2002. This will assure continuous updating of agency leadership on current human resources strategic planning issues.
- Reviewed computerized systems in use at other agencies to maintain inventories of mission-critical employee competencies, and began installation of modified software to support our own system. This database will allow en-

hanced workforce and succession planning ahead of the spike in retirements that the agency anticipates will begin over the next several years, due to employee demographics.

- Continued immediate implementation of newly available Web-based tools from the Office of Personnel Management (OPM) in support of the PMA. Recent enhancements under this e-Government initiative include: implementing the third component of e-Clearance, the Electronic Questionnaire Investigations Processing System, which provides for the electronic application, delivery, and processing of the Standard Form 86 security clearance form; Special Agreement Checks with OPM for suitability information prior to employment of candidates; activation of the Web-based Safety and Health Information Management System of the Department of Labor, to permit electronic processing of workers' compensation claims; active participation in the Enterprise Human Resource Integration Training Segment, to support analytical tools in strategic human capital planning and development, as well as support of the government-wide e-Payroll initiative and implementation of updated timekeeping software.
- Coordinated interactive training sessions, including via videoconference to regional staff, for both on-going training efforts to provide updates on industry, legal, and technical matters as well as new projects to enhance: understanding of benefits, including programs on retirement, flexible spending accounts, and dental insurance; skill of Commission supervisors and managers to effectively communicate and provide feedback to employees, through presentation of seminars on performance, conduct, and other related issues.
- Maintaining the Employee Resource Center (ERC), which contains a circulating library of paper-based and electronic resources encompassing career and life planning, training and development, health, employee assistance, and work and life balance. The ERC also hosts employee work groups, meetings, and educational outreach programs, including health seminars and preventive screenings, employee assistance programs, new employee orientation, transit subsidy distribution, performance management committee meetings and focus groups, and training program development committees.
- Managing the Employee Assistance Program (EAP), a free, confidential counseling program with 24-hour availability for employees and their family members to help with personal problems that may impact their work life. The EAP also includes on-site counseling and training to assist employees with personal and work problems, anxiety levels, and to help traumatized employees with recovery. The EAP also provides consultation to supervisors who have employees with performance and/or attendance problems.
- Updating the content and organization of both on-line references, including the *Employee Handbook* that provides important information about the Commission such as the basic principles governing employment in the Federal government, and outreach literature in the form of printed program and recruitment information that, along with a new recruitment CD, allows managers and employees to explain the CFTC mission and its employment opportunities efficiently, effectively, and with a consistent branding message in support of our strategic mission.
- Performing final edits to a new employee orientation Web page that will provide a user-friendly source of important information to new employees concerning their employment at the Commission. This new Web page will supplement the human resource information already available on Open Interest, the Commission's intranet Web site.

- Participating in OPM e-Training meetings to initiate a new consolidated training database help employees and managers track and evaluate training requests, reconcile training expenditures, and manage training-related reporting requirements, complaints, and claimants, as well as continuing to interface with key players in the e-Payroll, Recruitment One-Stop, and e-Clearance initiatives.

Management Operations

The Office of Management Operations (OMO) implemented an automated parcel tracking system called TrackPad. This system gives the Commission the capability to scan, barcode, and track all incoming parcels. Information is maintained in a database and can be sorted by name, date, tracking number, etc. It also tracks the internal delivery of received parcels to show the date, time, and the signature of the person who receives the package. This system has improved the efficiency of the mailroom operation through automation and the various reports that are available.

Major accomplishments during this fiscal year include the development of an Information Technology Disaster Recovery Plan, an agency-level Continuity of Operations Plan, a headquarters Occupant Emergency Plan, and program level Business Continuity Plans. Additional activities started this year and ongoing are implementation of the Disaster Recovery Plan, including build-out of the disaster recovery site, build-out of a Continuity of Operations Plan site, and enhancement of the Commission's information security awareness and training programs.

It is an "umbrella" plan that provides the policies, standards, and guidelines for the agency's operational-level contingency plans: Continuity of Operations Plan, Business Continuity Plans, Information Technology, Disaster Recovery Plan, and the Occupant Emergency Plan to continue essential agency functions and ensure employee safety across a wide range of potential emergencies.

In conjunction with the Continuity of Operations Plan, the Occupant Emergency Plan was implemented April 2004 and Town Hall meetings were conducted to present the new plan to headquarters' staff. The Town Hall presentation has been recorded and will be incorporated into the new employee orientation process. In addition, a template of the headquarters' Occupant Emergency Plan was developed for regional office locations. Regional locations will review the template and insert information as it relates to their specific location. By providing a template, the Commission has established continuity of information and emergency procedures for the Commission.

The OMO, in conjunction with the property management, has expanded current security levels at headquarters in order to enhance the security of our data and telecommunications networks by limiting access to secured areas and tracking access activity. The Commission is working with the property manager regarding upgrades to the existing system to provide enhanced reporting capabilities.

Program Contributions to Strategic Goals

Goal One: Ensure economic vitality of the commodity futures and option markets.

Breakout of Goal One Request by Program Activity

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Market Oversight	\$11,638	67	\$12,389	67	\$751	0
Clearing & Intermediary Oversight	538	3	572	3	34	0
Chief Economist	1,725	9	1,828	9	103	0
Enforcement	5,552	28	7,176	34	1,624	6
Proceedings	0	0	0	0	0	0
General Counsel	1,307	7	1,389	7	82	0
Executive Direction & Support	9,741	51	9,454	47	-287	-5
TOTAL:	\$30,501	165	\$32,808	167	\$2,307	2

Figure 6: Breakout of Goal One Request by Program Activity

Program Contributions to Goal One

Market Oversight

The Commission's regulatory structure for exchanges and other trading systems is designed to encourage growth in the number of entities trading futures and options in the U.S. as well as an increased number of innovative futures and option contracts in both traditional and nontraditional commodity areas. New and existing U.S. exchanges will list new products for trading in their efforts to compete with foreign exchanges to meet the hedging and price-discovery needs of a wide array of firms in the marketplace, and as part of their efforts to introduce novel products that present new approaches to futures trading. Moreover, a significant number of these new markets may seek Commission recognition as contract markets in security futures or as derivatives transaction execution facilities (DTEF). The Commission expects the number of active futures and option markets requiring surveillance to increase from 556 in FY 2004 and to 575 in FY 2005 and to 650 in FY 2006. Most of these new contracts will be security futures and energy futures. Many new exchanges will trade contracts only on electronic systems or simultaneously through electronic and open outcry systems. Industry efforts to integrate financial cash market trading and over-the-counter derivatives trading through common electronic trading platforms or other mechanisms will increase the importance of a surveillance effort that examines the relationship between futures and option contracts and the underlying commodity, instrument, or interest. In view of an FTE allocation of 50 for the Market Surveillance subprogram for FY 2006, the Market Oversight program anticipates that surveillance economists will produce 2,350 weekly surveillance sheets in FY 2006 as compared to 2,100 in FY 2005.

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Streamlining Large Trader Reporting. In FY 2000, the Commission introduced its reengineered computer system that supports market surveillance. Enhancements to that system continued in FY 2004. Additional capability was added in order to support trading by new exchanges and new types of contracts, such as swap futures and low notional value futures and options. The anticipated growth in U.S. futures and option trading, new types of contracts, and new exchanges will increase significantly the volume and type of surveillance data that this system must process. In order to maintain adequate computer system processing speed for this growth in data, and to support surveillance analysis of new types of products, improvements will continue to be made to system hardware and software. Staff time will be devoted to assuring that these data are received and processed in an accurate and timely manner. Surveillance staff also will continue testing and modifying, as appropriate, enhancements to the core elements of the surveillance computer system.

Review of Commission Regulations. The Commission will continue a broad review of its regulations to eliminate rules made obsolete by the recent amendments to the Act and the rules promulgated to implement the CFMA. It will also review its rules to further streamline and coordinate regulations across markets. The review is being conducted under the leadership of the Market Oversight division with representatives from all program areas of the Commission. In FY 2005, the Market Oversight program plans to continue in a leadership role in implementing further regulatory reforms to be adopted by the Commission to accommodate innovations in derivatives trading.

New Exchanges, Products and Rule Amendments. As a result of ongoing changes in technology, including advances in electronic trading, the use of the Internet for executing transactions, the introduction of trading in single-stock futures, and the launch of new exchanges offering innovative products in new areas, the number of derivatives exchanges is expected to grow, consisting of designated contract markets and DTEFs, as well as, exempt markets. These new exchanges, as well as existing exchanges, are developing derivatives products based on various nontraditional "commodities," including diverse tangible commodities, services, and indexes of commercial or economic activity and events. Exchanges also continue to innovate by developing new security futures products.

In view of these considerations, four new exchanges are expected to file with the Commission during FY 2006 for approval as contract markets or DTEFs, and four entities are expected to notify the Commission as exempt markets. In addition, 210 new contracts are projected to be filed with the Commission under the certification procedures, with 10 requests for approval of products. This projection is based on: 1) the existing and prospective exchanges' continuing interest and competition in developing innovative futures and option contracts in the financial, physical commodity, and other sectors; 2) the prospects for joint ventures between existing exchanges and business-to-business facilities to develop derivatives markets; 3) the expansion of single-stock futures trading; and 4) the tendency to establish option contracts on futures that have traded successfully. In addition, 150 economically significant rule changes are expected to be submitted during FY 2006. These will include a number of significant changes to existing rules to maintain conformity with changing cash market practices. The trend toward development of new innovative products will continue through FY 2005 and FY 2006. Finally, the number of non-product-related rule changes are expected to increase in FY 2006 as contract markets and DTEFs continue to establish new automated trading systems, innovative market structures, and new trade execution procedures.

The Market and Product Review subprogram will continue to review, for compliance with applicable designation or registration criteria and core principles con-

tract market designation and DTEF registration applications. In addition staff will conduct due diligence reviews of new product filings and rule submissions.

Clearing & Intermediary Oversight

Oversight and Review of Financial Risk Management. During FY 2005 and FY 2006, the Clearing and Intermediary Oversight program's new Financial Surveillance unit, one of two new units created within the program during FY 2004, will serve to enhance and expand the program's utilization of automated tools and systems to gather, combine, and analyze information from monthly financial reports filed by FCMs, large trader position information, and other relevant market and financial information so as to provide ongoing surveillance of actual or potential financial risks facing firms and clearinghouses and to anticipate emerging problems that may pose systemic risks. These tools and systems enable a more proactive approach and allow financial and risk information to be compiled, analyzed, communicated, and acted upon more quickly, efficiently, and effectively to prevent or react appropriately to circumstances where futures firms may become under-segregated or undercapitalized.

The Clearing and Intermediary Oversight program also will monitor major market moves in an attempt to identify and respond to potentially disruptive situations that adversely affect the financial condition of the market or market participants. Program staff will work on a case-by-case basis to develop appropriate, innovative, and pragmatic responses to such market events. Areas of focus during FY 2005 and FY 2006 may include: 1) systemic risk issues; 2) changes in the markets that further link cash and derivatives (on-exchange and off-exchange); 3) cross-border trading; and 4) growth in the number of automated trading systems.

During FY 2005 and FY 2006, the Clearing and Intermediary Oversight program will work internally and with the industry to review contingency plans, improve communications, and assess best practices to develop sound disaster recovery plans.

Information Efforts on the Functions and Utility of the Markets. During FY 2005 and FY 2006, the Clearing and Intermediary Oversight program will continue to support the PWG, participate in Commission advisory committee efforts, and expand its role in both interagency and private sector intermarket coordination activities. The Clearing and Intermediary Oversight program and the OIA will coordinate Commission efforts with those of foreign regulators and professional organizations in the areas of accounting, capital, market surveillance, and financial compliance, with particular focus upon linkages, full service financial firms, and new products.

Enforcement

The Enforcement program will be required to devote an increased level of resources for investigation and litigation in response to challenges to the proper economic functioning of the markets presented by manipulative and abusive trading practices. Domestic and foreign markets are becoming increasingly inter-related as technology develops, regulatory barriers are eliminated, and formal links are established between markets. Changes in the regulatory and technological environment for exchanges facilitate trading by institutional market participants. These regulatory and technological changes enable traders to employ complex strategies more easily and could permit abusive conduct in one market to cause greater harm in other related markets.

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Manipulation and trade practice investigations and cases tend to be among the most complex and resource-intensive matters handled by Enforcement staff for several reasons: 1) staff must analyze complex trading strategies and the intricacies of the underlying cash markets; 2) investigations require detailed reconstruction of trading using voluminous records; and 3) assistance sometimes is required from or provided to domestic and foreign regulators. Historically, the Enforcement program has had to deal with a relatively small number of these resource-intensive matters at any one time. However, developments indicate that Enforcement staff will be called upon to investigate and prosecute a significant number of such matters during FY 2005 and FY 2006, which will severely stretch the Enforcement program's resources.

The Commission identification of wrongdoing in the energy markets, for example, resulted in large-scale investigations. While the Commission has made great progress in completing in a timely matter its investigation of wrongdoing by numerous energy companies, including Enron and its affiliates, other developments, such as the Commission's investigation of a price spike in the Natural Gas Market indicate that work in the energy sector will remain a major Enforcement program area. Accordingly, the Enforcement program expects to maintain its recently increased focus on investigations of disruptive or potentially disruptive market situations in order to address price manipulation and fraudulent trading practices.

Office of Chief Economist

Research on Market Functions and Developments. In FY 2005 and FY 2006, OCE staff will continue to examine the alternative execution procedures in futures markets. This will include comparison of the liquidity and price discovery of open-outcry systems versus electronic trading systems with supporting details on related economic theories and empirical evidences. This effort should provide valuable input in formulating policy proposals by Commission staff. In pursuit of the same purpose, OCE staff also is examining alternative derivative markets based upon states of nature and various types of events.

During this same time period, OCE staff also will examine market structural issues arising from interest from certain futures market participants in common clearing. OCE staff also will provide economic and statistical analyses to the Enforcement program on a number of cases, including retail forex fraud and potential market manipulations.

Derivative Risk Management and Risk-Based Capital Requirements. The rapid growth of derivative markets has dramatically increased the potential impact of derivatives on the stability of international and domestic financial markets. Derivative risk management and risk-based capital requirements are the major tools to maintain the financial integrity of futures and option markets and reduce systemic risk of the financial markets. In FY 2005 and FY 2006, OCE staff will continue to examine the following risk management and risk-based capital issues: 1) analytic models for analyzing, measuring, and monitoring futures market risk and liquidity risk and major issues in implementing a market risk measurement system; 2) alternative models on risk-based capital requirements and quantitative methods for evaluating the adequacy of capital requirements; and 3) evaluation of risk-based margin systems, including the Standard Portfolio Analysis of Risk Margin Systems for futures and options on futures and the Theoretical Intermarket Margin System for options on equities.

Office of Proceedings

The Office of Proceedings will continue to hear and decide administrative enforcement cases brought by the Commission during FY 2005 and FY 2006.

Office of the General Counsel

Contract Market Designation Applications. OGC will continue to review contract market designation applications, as well as applications for registration as DTEFs and DCOs, for legal sufficiency and conformance with the CEA and Commission policy and precedent.

Manipulation and Other Abusive Trading Practices. OGC will continue to review all enforcement recommendations involving the initiation of investigations and all proposed enforcement actions alleging manipulation and other abusive trading practices to assure their legal sufficiency and conformance with Commission policy and precedent.

Coordination of Information and Efforts Among U.S. Regulators. OGC will continue to coordinate with other members of the PWG and other Federal regulators on issues as necessary.

Providing Information on the Functions and Utility of the Markets through Public Meetings. OGC will continue to provide the Commission with guidance on both procedural and substantive matters in connection with the public meetings of its three advisory committees—the Agricultural Advisory Committee (AAC), the Global Markets Advisory Committee (GMAC), and the Technology Advisory Committee (TAC)—and all other public Commission meetings.

Executive Direction & Support

Agency Direction. The increasing global electronic integration of the commodity futures and option markets requires the entire international regulatory community to cooperate as technology significantly increases cross-border trading volume, cross-market participation, and cross-border exchange combinations. OIA will coordinate with regulators throughout the world to: 1) facilitate cross-border business through the elimination of unnecessary legal and practical impediments; 2) enhance customer and market protections through cooperative arrangements; and 3) encourage market discipline through enhanced transparency. The Commission anticipates that the Trans-Atlantic Cooperation Initiative entered into with the Committee of European Securities Commissions will result in enhanced efforts to develop practical mechanisms to enhance cross-Atlantic business and supervisory cooperation.

Administrative Management & Support. In FY 2005 and FY 2006, the Office of Information Resources Management (OIRM) will continue to refine the Integrated Surveillance System, responding to key changes in the market and internal market surveillance requirements. The Commission will also continue to refine the Integrated Surveillance System to further automate CFMA requirements for oversight of Exempt Commercial Markets, such as Intercontinental Exchange, Houston Street, NGX, and Trade Spark. Accordingly, the Commission will design and develop new Integrated Surveillance System software systems to efficiently and effectively capture, store, and analyze Exempt Commercial Markets trade data. In addition, Integrated Surveillance System will upgrade its internal processing to more efficiently and effectively manage surveillance data.

In FY 2005, the OIRM will continue to support the Commission as it expands its monitoring and oversight of the new electronic exchanges. These electronic exchanges are being created by both existing open outcry exchanges and new exchanges where trading is only done electronically. The number of markets is expanding rapidly and the volume of trade data is significantly greater than the open outcry markets. Trade data from these new electronic platforms will be in-

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cluded with the traditional open-outcry exchange systems as part of an enhanced Exchange Database System.

In FY 2005, the OIRM will continue with its ongoing technical improvements to the Exchange Database System, improving the Commission's ability to identify irregularities and offenses in the markets. The timeliness and scope of these investigations will be enhanced by the increased availability of trade data and the advanced capability of a trade practice surveillance system.

In FY 2005 and FY 2006, the Commission will begin work on the development of the TRADE system. This system will modernize the Commission's market oversight and trade practice surveillance capability. After the contract award in FY 2005, the Commission will gather requirements for TRADE, conduct a technical assessment, and develop the TRADE technical architecture, data architecture, and system design. In FY 2006, software development will result in a phase one rollout of the system. The Commission also will increase network bandwidth in support of TRADE, which will significantly improve availability, usability and recoverability of trade data. The bandwidth increase will enhance system access speed by over 300 percent and support system redundancy in the event of a disaster.

Goal Two: Protect market users and the public.

Breakout of Goal Two Request by Program Activity

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Market Oversight	\$0	0	\$0	0	\$0	0
Clearing & Intermediary Oversight	4,894	26	5,213	26	319	0
Chief Economist	0	0	0	0	0	0
Enforcement	17,905	89	16,797	79	-1,108	-10
Proceedings	2,338	13	2,486	13	148	0
General Counsel	3,316	17	3,525	17	209	0
Executive Direction & Support	8,560	45	10,239	51	1,679	6
TOTAL:	\$37,013	190	\$38,260	186	\$1,247	-4

Figure 7: Breakout of Goal Two Request by Program Activity

Program Contributions to Goal Two

Clearing & Intermediary Oversight

Oversight of Sales Practices and Registered Futures Associations. Clearing and Intermediary Oversight program staff will oversee the regulatory programs conducted by NFA, as a Registered Futures Association (RFA). The Clearing and Intermediary Oversight program may include reviews of NFA's operations, such as sales practice and other compliance programs for CPOs and CTAs, FCMs, and IBs, and their branch offices. If additional futures associations become registered, DCIO staff will oversee these RFAs as well.

Similar to the approach of other federal financial regulators and certain overseas financial supervisors, indeed, in close consultation with several such peers, the DCIO has begun to enhance its supervision of exchanges, clearinghouses, and other self-regulatory organizations with risk-based examination cycles and RFAs, risk-focused reviews. Both the scheduling and scope of DCIO's supervisory reviews will now be based on careful analysis of the underlying risks to which an institution is exposed and the controls which it has in place to address those risks. This approach promises to better utilize supervisory resources and to help ensure even greater financial integrity and risk management within the firms and clearinghouses that are the backbone of the futures clearing system. The Major Reviews unit, one of two new units within DCIO, was created during FY 2004 to plan, coordinate, schedule, monitor, and assess major risk-focused reviews. The unit's activities are intended to ensure that multiple, simultaneous major reviews are completed on schedule, follow appropriate benchmarks of consistency and comparability, and, ultimately, provide meaningful assessments of core principle compliance which, when presented formally to the Commission, permit the Commissioners to assure themselves that the Commission is fulfilling its responsibilities on this important aspect of market oversight.

Clearing and Intermediary Oversight staff will refine the procedures it has developed to review the self-regulatory programs of new electronic exchanges, particularly the clearing and financial reporting and record-keeping compliance pro-

grams of such entities. DCIO staff will conduct selected FCM, CPO, CTA, and IB audits to test self-regulatory programs. DCIO staff also will conduct examinations on behalf of the Enforcement program and provide technical assistance to the Enforcement program as needed, particularly with the area of off-exchange retail foreign currency transactions.

Clearing and Intermediary Oversight program staff will continue to review all customer complaints received by the Commission as part of the effort to determine if customer protection issues arise in connection with new markets and new products offered on new and existing markets. DCIO staff will continue to confer periodically with NFA and any other RFA on marketing issues. In this regard, such coordination may become more critical in the event NFA or any other RFA takes on additional audit responsibilities for existing and new exchanges.

Oversight of Intermediary Fitness. The Clearing and Intermediary Oversight program staff will oversee the NFA's fitness review program (registration) through formal reviews of the program, informal staff contacts, and meetings of the Registration Working Group. The Clearing and Intermediary Oversight program will continue to work with other Commission staff to provide input and feedback to NFA on its online registration system. If additional futures associations apply for registration and become registered, the program will oversee these RFAs as well.

As the pace of technological change quickens, Clearing and Intermediary Oversight program staff will review rules and other guidance provided to the industry to ensure that customer and marketplace protections are maintained and enhanced. In connection with such efforts, staff will modify oversight programs to conform to any changes in the way market and credit risk are assessed pursuant to relevant capital rules and related reporting requirements. DCIO staff will continue to examine firms' risk assessment and internal control oversight programs. **Anti-Money Laundering.** Clearing and Intermediary Oversight program staff have participated in both an interagency working group and an internal Commission task force responsible for making recommendations on rulemakings to implement the AML provisions (Title III) of the USA PATRIOT Act. Clearing and Intermediary Oversight staff have provided input and assistance for the U.S. Treasury Department in developing rules as required under Title III. Treasury delegated its anti-money laundering examination authority with respect to FCMs, IBs, and CTAs to the Commission in November 2003 and, accordingly, the Major Reviews unit, one of two new units within the Clearing and Intermediary Oversight program's Audit and Financial Review section, was created during FY 2004 to, among other things, develop and review standards for the examination of registrant compliance with AML requirements and oversee the efforts of self-regulatory organizations.

Enforcement

The Enforcement program will continue to commit the majority of its resources to investigating and litigating cases involving fraud to protect market users and the public from abuse. The Enforcement program also will focus on cooperative enforcement, both domestically and internationally.

Properly staffed, the Enforcement program is able to investigate rapidly and take injunctive action in quick-strike cases⁴ without diverting staff from large, complex matters. The Enforcement program uses its quick-strike capability effectively to prosecute those engaged in ongoing fraud where customer funds are at risk. Such quick-strike cases not only send a deterrent message, but they also

⁴ "Quick-strike" cases are civil injunctive enforcement actions filed by the Commission within four months of the opening of the related investigation.

provide the Commission with the opportunity to freeze assets and preserve books and records whenever possible.

While it is difficult to project what new issues or trends will require an enforcement response, certain current circumstances are likely to be indicative of future resource needs, such as: 1) continued industry growth⁵; 2) the development of technology that allows more complicated trading strategies and enhanced ease of access, including from abroad, to a wider customer base through the Internet and other mass media; 3) the increased volume of pooled and managed money flowing into the industry; and 4) challenges to the Commission's jurisdiction with respect to foreign currency transactions, which was statutorily clarified in the CFMA.

The Enforcement program anticipates that staff will continue to devote attention to cases in which defendants use mass media to reach broad cross-sections of the general public, including unsophisticated customers. The Enforcement program in the past has pursued cases involving solicitation fraud, including false advertising, but the fact patterns in these cases continue to evolve and grow increasingly complex. Moreover, with the increased use of mass media, such as the Internet, these solicitations are reaching more retail customers than ever before.

With the volume of investment dollars flowing to pooled and managed funds, the Commission also continues to pursue numerous cases involving registered and unregistered CPOs and CTAs engaged in fraudulent conduct. The Enforcement program anticipates that during FY 2005 and FY 2006, it will devote increased attention to the CPO/CTA disclosures regarding the risks associated with trading and their profitability and capitalization.

The Commission expects to continue to devote resources to matters involving the sale to retail customers of illegal futures and option contracts, including those involving precious metals and foreign currency, by unregulated entities until the problem abates. This area has been an attractive one for scam artists, and further growth in this area can be anticipated if they are successful in their numerous jurisdictional challenges to the Commission's enforcement efforts.

Cooperative Enforcement. The Commission also is dedicated to maintaining both its domestic and international cooperative enforcement activities. The relationships that the Enforcement program has forged with federal, state, and local authorities are invaluable to the efforts of the Commission to fulfill its mission. The Enforcement program fully expects that its investigations will continue to require assistance from foreign authorities. The Commission has entered into formal cooperative enforcement arrangements with more than 20 foreign authorities and continues to negotiate additional arrangements as authorities obtain comprehensive investigatory powers. Much of the international work can be labor-intensive, given differences in language and regulatory schemes. Similarly, effective domestic cooperative enforcement requires that strong relationships be built over time.

Statutory Disqualification. Finally, the Enforcement program expects the amount of staff time and resources devoted to statutory disqualification investigations and cases in FY 2005 and FY 2006 to remain small but steady. The Enforcement program expects that it will continue to investigate and prosecute certain significant statutory disqualification matters as well as disqualifications that are related to matters previously prosecuted by the Commission.

⁵ The futures markets are large and growing. In FY 2003, approximately one billion futures contracts were traded domestically on eleven exchanges, and there were approximately 80,000 Commission registrants.

Penalties Collection. Prior to the end of FY 2002, responsibility for assuring that civil monetary penalties assessed in Commission cases—formerly within the purview of the Commission's former of Trading and Markets program—was transferred to the Enforcement program. Consistent with prior practice, the Enforcement program may turn over to the U.S. Treasury delinquent debts for cross-servicing, administrative offsets, and wage garnishments in accordance with both the Debt Collection Improvement Act of 1996 and the letter of agreement entered into between the Commission and the U.S. Treasury Department. The Commission may also, in appropriate cases, continue to refer delinquent debts directly to the Department of Justice to enforce collection. The Enforcement program will monitor the progress of each such case.

Office of Proceedings

During FY 2004, commodity futures and option markets continued to expand into new areas, and the volume of trading grew. However, the Commission expects the number of reparations complaints filed to remain at 112 in both FY 2005 and FY 2006.

Office of the General Counsel

Deterring Fraud and Other Illegal Activities. OGC will continue to review all enforcement recommendations involving the initiation of investigations and all proposed injunctive actions and administrative proceedings involving fraud and other violations to assure their legal sufficiency and conformance with Commission policy and precedent. In addition, OGC will continue to assist the Commission in the performance of its adjudication, litigation, *amicus curiae*, and bankruptcy functions.

Requiring Commodity Professionals to Meet High Standards. OGC will continue to support Commission oversight of the NFA program by reviewing statutory disqualification cases, reviewing the Commission's delegations of registration and other authority to the NFA, and participating in the Registration Working Group.

Providing a Forum for Handling Customer Complaints Against Registrants. OGC will continue to assist the Commission in resolving appeals from initial decisions in reparation cases and will represent the Commission when its reparation decisions are appealed to the U.S. Courts of Appeals.

Anti-Money Laundering. OGC will continue working with the U.S. Treasury Department, other Federal financial regulators, and interested parties to develop anti-money laundering rules required by the USA PATRIOT Act, and to issue guidance regarding the implementation of those rules. OGC also will be coordinating with market participants, the NFA, and other Commission programs on compliance and examination issues as these new rules continue to come into effect.

Executive Direction & Support

Administrative Management & Support. In FY 2005, the Commission will begin the Project eLaw system implementation. The eLaw solution, a set of commercial-off-the-shelf products, will support the Commission's legal practice in the areas of case planning, case management, litigation support, and document management. The implementation of each product will be done in a pilot phase initially, and followed by full implementation. The full implementation of all products will be completed in FY 2006. The Commission also will increase network bandwidth in support of the Project eLaw system, which will significantly improve availability, usability and recoverability of trade data. The bandwidth in-

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crease will enhance system access speed by over 300 percent and support system redundancy in the event of a disaster.

In FY 2005, the Commission will modernize systems supporting administrative and reparations case management systems. Case tracking for these types of matters will be implemented as part of the Commission-wide Project eLaw effort. Docket management and sanction reporting will be addressed through separate technical modernization initiatives. Sanction reporting and publication of sanction business processes will be modernized to support more frequent posting of information to the Internet. This activity will result in information to the public being readily accessible and current.

Goal Three: Ensure market integrity in order to foster open, competitive, and financially sound markets.

Breakout of Goal Three Request by Program Activity

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Market Oversight	\$5,716	32	\$6,108	32	\$392	0
Clearing & Intermediary Oversight	6,149	34	6,540	34	391	0
Chief Economist	0	0	0	0	0	0
Enforcement	4,466	22	5,592	26	1,126	4
Proceedings	180	1	191	1	11	0
General Counsel	1,570	8	1,669	8	99	0
Executive Direction & Support	7,979	41	8,218	40	239	-1
TOTAL	\$26,060	138	\$28,318	141	\$2,258	3

Figure 8: Breakout of Goal Three by Program Activity

Program Contributions to Goal Three

Market Oversight

Promoting Effective Self-Regulation & Protecting Markets from Abusive Trade Practices. During FY 2006, the Market Compliance subprogram staff will continue to monitor changes in the marketplace that result from new electronic trading systems, advances in order routing technology, the globalization of the markets, and new market practices and trading strategies. The Market Compliance staff will also implement any regulatory initiatives resulting from the Commission's study of self-regulation in the futures industry. Staff is performing a broad review of exchanges, clearing organizations, and the NFA to evaluate the role and effectiveness of SROs as the structure of the futures markets continue to change, and to assess their methods of fairly and effectively fulfilling their self-regulatory responsibilities in light of recent changes in the industry. In addition, Market Compliance staff will conduct extensive examinations of SRO programs for enforcing their rules, including those relating to trade practice surveillance, market surveillance and disciplinary matters; monitor daily trading activity for potential violations of the Act and the Commission's regulations; and review and evaluate SRO disciplinary actions. The Market and Product Review subprogram will review exchange rules and rule amendment filings and develop rules to foster open and competitive markets and protect the public interest.

The Market Compliance subprogram staff will conduct three rule enforcement review examinations of SRO compliance activities in FY 2005 and three such reviews in FY 2006. These reviews focus on the affirmative compliance programs through which SROs enforce their rules. Such reviews also will focus on assuring adherence by contract markets to the core principles governing such entities under the regulatory framework of the CFMA. These reviews have taken on increased importance as one of the Commission's principal regulatory tools in its transformed role of oversight regulator under the CFMA.

With respect to deterring and detecting abusive trading practices, the Market Compliance subprogram staff will continue to monitor each market for potential trading violations by conducting routine trade practice investigations. In FY 2005, staff will conduct 110 trade practice investigations, and staff will conduct the same number in FY 2006. Market Compliance subprogram staff will refer instances of potential violations to the Commission's Division of Enforcement or to the relevant exchange for further investigation. Market Compliance subprogram staff will also continue development and implementation of enhancements to the automated trade surveillance system at the Commission. These activities promote markets that are free of trading abuses.

With the assistance of outside consultants, the Market Compliance subprogram staff will continue to develop and begin to implement an enhanced electronic trade database and surveillance system. Market Compliance subprogram staff also will begin developing new approaches to trade surveillance that are tailored specifically to electronic trading systems.

In both FY 2005 and FY 2006, Market and Product Review subprogram staff expect to review approximately 280 market-related rule and rule amendment submissions to ensure the protection of customers and the fair treatment of market participants, while accommodating product innovations and fostering efficiency. Areas of possible activity include new exchanges, exchange mergers, demutualization of exchanges, links with over-the-counter markets and foreign exchanges, automated trading systems, and various alternative trade execution procedures off the centralized marketplace.

The Market and Product Review subprogram will continue to address ongoing regulatory issues regarding application of the multitude of new exemptions and exclusions in the CFMA with respect to trading of derivatives and the oversight of an increased number of trading facilities and products that may involve cross-border linkages. Additionally, the Market and Product Review subprogram staff will work with the SEC to coordinate necessary rulemakings with respect to the trading of security futures products by futures and securities exchanges.

The Market Oversight program staff also will continue to review no-action requests from foreign boards of trade seeking to place terminals in the U.S. without being designated as a contract market or registered as a DTEF. In addition, the Market and Product Review subprogram staff will review and monitor innovative trading mechanisms developed by the energy industry in response to the deregulation of that industry, particularly those existing in an off-exchange environment, and the program will continue to provide guidance and appropriate regulatory relief by no-action letter and other available means.

Clearing & Intermediary Oversight

Fostering Sound Business Practices: Financial Surveillance and Risk Assessment. In FY 2005 and FY 2006, the Clearing and Intermediary Oversight program will maintain and its ongoing activities to ensure sound business and financial practices. These program activities will face increased demands due to the growing complexity of market structures and product innovations in an increasingly global marketplace.

In addition to the expansion of markets and products, the Clearing and Intermediary Oversight program will need to address several proposals and the effects of such proposals on the financial integrity of firms and their SROs. Clearing and Intermediary Oversight program staff anticipate that to fortify risk management

absorption it will require additional staff resources for the assessment of risk management capabilities and financial integrity at FCMs, SROs, and DCOs.

The Clearing and Intermediary Oversight program will continue to review the Commission's existing regulatory requirements and gather input from registrants and other financial industry participants in order to recommend, for adoption by the Commission, appropriate amendments to regulations that deal with issues of: 1) expanding permissible investments of customer segregated funds; 2) including additional instruments in segregation; and 3) allowing customers electing to "opt-out" of having their funds held in segregation.

Oversight of Market Intermediaries. The Clearing and Intermediary Oversight program will continue its oversight of firms' financial condition. The Clearing and Intermediary Oversight program addresses the review of FCMs and IBs for appropriate risk management capabilities to prevent financial problems at a single firm from becoming systemic problems that may affect other firms or markets or market participants. The Clearing and Intermediary Oversight program also will continue to review and recommend appropriate revisions of the capital rules for FCMs and IBs so that such firms, the exchanges, and the clearing organizations can enhance their operating efficiency while maintaining a sufficient capital cushion. This is a continuation of the effort started in FY 2004 in which the Commission approved certain rule amendments that modernize regulatory minimum capital requirements for FCMs. Under these rule amendments, an FCM's minimum capital requirement is no longer based on a percentage of customer funds held by the FCM, but rather on specified percentages of the risk maintenance margin requirements for all positions the FCM holds for customers and certain affiliated entities and employees. These rule amendments correlate a firm's capital requirement to the particular risks of the futures and options positions the firm carries, and are consistent with the risk-based capital requirements that several futures organizations have implemented previously for their member firms. In FY 2005, the subprogram staff will be working with the exchanges, the NFA, and other industry participants to ensure the smooth implementation of the new capital requirement. Certain forms of FCM financial statements also would have to be updated to reflect the capital requirement change.

Risk-Focused Oversight Programs for Clearinghouses and SROs. Similar to the approach of other federal financial regulators and certain overseas financial supervisors, indeed, in close consultation with several such peers, the DCIO has begun to enhance its supervision of exchanges, clearinghouses, and other self-regulatory organizations with risk-based examination cycles and risk-focused reviews. These reviews may cover a single institution's compliance with multiple core principles (vertical reviews) or may cover the compliance by multiple institutions with a single core principle or several related core principles (horizontal review). Both the scheduling and scope of the DCIO's supervisory reviews will now be based on careful analysis of the underlying risks to which an institution is exposed and the controls which it has in place to address those risks. This approach promises to better utilize supervisory resources and to help ensure even greater financial integrity and risk management within the firms and clearinghouses that are the backbone of the futures clearing system. The Major Reviews unit, one of two new units within the DCIO, was created during FY 2004 to plan, coordinate, schedule, monitor, and assess major risk-focused reviews. The unit's activities are intended to ensure that, where staff resources permit, multiple, simultaneous major reviews can be completed on schedule, follow appropriate benchmarks of consistency and comparability, and, ultimately, provide meaningful assessments of core principle compliance which, when presented formally to the Commission, permit the Commissioners to assure itself that the Commission is fulfilling its responsibilities on this important aspect of its market oversight.

The first review under this program was completed in early FY 2004. After reviewing these efforts, staff initiated another review and expect to begin additional reviews in FY 2005 and FY 2006. In FY 2005 and FY 2006, available program staff will continue to conduct examinations of Commission registrants, process risk assessment filings by FCMs, and review financial reports from FCMs and IBs. In addition, staff will monitor the efforts of NFA in reviewing commodity pool annual reports, which the Commission authorized NFA to conduct in FY 2003. Staff also anticipate continuing support to the Enforcement program on accounting matters and the application of financial requirements. Finally, staff will continue to submit to the Commission formal reports on the program's oversight of SROs.

Ensuring a Regulatory Environment that is Flexible and Responsive to Evolving Market Conditions. Continuing in FY 2005 and FY 2006, the Clearing and Intermediary Oversight program will support the Commission's ongoing regulatory reform program, as well as actions required by or appropriate to the implementation of the CFMA. Clearing and Intermediary Oversight program staff will continue to review the Commission's existing regulatory requirements and gather input from registrants and other financial industry participants in order to recommend for adoption by the Commission appropriate amendments to regulations that are: consistent with the goals and principles of the CFMA as well as any further changes in the CEA enacted during the 2005 reauthorization process; and flexible enough to maintain a regulatory framework that is effective, efficient, and relevant to developments in financial markets. Rulemakings, reports, and guidance from the Clearing and Intermediary Oversight program will continue to be important regulatory outputs in the new oversight environment created by the CFMA's regulatory framework and as SROs work to adhere to the framework's core principles while responding to the demands of the futures marketplace for innovation and global competitiveness. Clearing and Intermediary Oversight program staff will, as necessary, develop and promulgate regulations and promote standards that provide appropriate guidance to market participants, but that continue to allow sufficient flexibility. The Clearing and Intermediary Oversight program will also provide assistance to industry participants, counsel, RFAs and the public in interpreting and applying the new regulatory framework to specific factual situations. Clearing and Intermediary Oversight program staff will continue to provide guidance and relief as appropriate to the public, persons new to the futures industry, RFAs and market professionals on a wide range of basic compliance matters, such as registration, disclosure, record-keeping, and treatment of customer funds.

New Products and Market Structures. The Clearing and Intermediary Oversight program will continue to address ongoing regulatory issues regarding the application of a multitude of new exemptions and exclusions in the CFMA with respect to the trading of derivatives, as well as oversight of an increased number of clearing organizations, products, and RFAs. Clearing and Intermediary Oversight program staff will also continue to respond to: 1) expanding use of electronic and communication technology; 2) electronic trading systems and cross-border transactions; and 3) resulting changes in how markets are accessed by participants and how intermediaries conduct business with customers. Clearing and Intermediary Oversight program staff will address potential systemic problems and risks through timely preparation of reports and guidance relating to major market events. Clearing and Intermediary Oversight program staff will continue to address the creation of new clearing structures and the proliferation of new electronic execution facilities for derivatives.

Security Futures Products. The Clearing and Intermediary Oversight program will continue to work with the SEC to coordinate rulemakings with respect to the

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implementation and trading of security futures products. In this regard, Clearing and Intermediary Oversight program staff will focus upon the issues of customer margin, protection of customer funds, registration of intermediaries, foreign security futures products, and possible further exemptions for notice registrants. In addition, Clearing and Intermediary Oversight program staff may participate in the development of rules and procedures for trading options on security futures. Clearing and Intermediary Oversight program staff will continue to work with NFA and other SROs to develop appropriate testing procedures for market participants who trade security futures products. Clearing and Intermediary Oversight program staff also expect to continue working with SEC staff and industry representatives in connection with the development and introduction of portfolio margining for securities products, including security futures products. Clearing and Intermediary Oversight program staff also anticipate responding to inquiries from intermediaries, their counsel and accountants, and the general public concerning operational issues as the market for security futures products develops.

Cooperation with the SEC. In implementing requirements of the CFMA, and in accordance with recommendations contained in the Commission's report on intermediaries, the Commission intends to work with the SEC to address the following issues related to futures and securities intermediaries: 1) standardizing definitions for sophisticated customers and the relief available to intermediaries dealing solely with such customers; 2) establishing a standard determination or a safe harbor as to when the business of a CTA or investment advisor does not consist of "primarily" acting as the other, so as to provide additional exemptions from registration; and 3) coordinating Commission and SEC reviews of offering materials of publicly offered commodity pools to minimize the time and costs imposed by duplication of efforts; and 4) reviewing proposals for cross-margining of securities and futures products. Consistent with the recently signed MOU between the CFTC and the SEC, the Commission and Clearing and Intermediary Oversight program staff will coordinate inspections of notice-registered intermediaries, exchanges and limited purpose national securities associations. Staff also will work with the SEC in connection with implementation of the SEC's new rules for consolidated supervised entities as they apply to FCMs. Staff also will work with the Office of General Counsel to support the Commission's Chief of Staff as he interfaces with the SEC, pursuant to the PWG's direction, to commence a dialogue on how a "carve out" and/or other measures may be developed to avoid redundant, duplicative, or unnecessary regulatory burdens on CFTC registrants under the SEC's recently-adopted rules concerning investment advisors to hedge funds.

Enforcement

The Enforcement program will continue to devote resources to its role in fostering open, competitive, and financially sound markets through investigations and prosecutions relating to financial, supervision, and compliance failures by firms handling customer funds and trade practice abuses by market participants. In addition, the recent USA PATRIOT Act and anti-money laundering regulations require registered firms to implement reporting, compliance, and customer identification and verification programs to fight money laundering.

Supervision, Compliance, Control & Record-keeping. The Enforcement program anticipates that its investigation and prosecution of significant supervision, compliance, and internal control failures may grow as trading volume increases and regulated firms compete aggressively for customers in a changing regulatory and technological environment. Such violations threaten the financial integrity of registered firms holding customer funds and, if large enough, can threaten the financial integrity of clearing organizations. In addition, without adequate supervision and compliance systems in place, customers remain vulnerable to fraud,

including misallocation of trades and unauthorized trading. Diligent supervision by registered firms also protects markets from the abusive practices of traders, including wash sales and manipulation. Such cases tend to be complex and time consuming, requiring extensive testimony from employees and managers in the supervisory chain. These cases can result in substantial remedial changes in the supervisory structures and systems in large FCMs following comprehensive reviews by the firms pursuant to Commission orders. These cases have had a significant impact on the way firms do business and are an important part of the responsibility of the Commission to promote sound practices by registered firms.

Enforcement staff will continue, in the first instance, to rely on SROs and independent auditors to monitor compliance and supervision by registered firms. Where appropriate, however, Division staff will undertake aggressive investigations and prosecutions to remedy failures in this area.

Trade Practice. Enforcement staff will continue to prosecute trade practice violations in appropriate cases. The Commission is responsible for fostering markets that are free of manipulative and fraudulent trading practices. Exchanges play an important role in assuring open, competitive markets through surveillance and disciplinary actions. Their technological improvements and enhanced audit trails may impact the number of Commission enforcement actions in this area. Nevertheless, their jurisdiction is limited and certain misconduct crosses product lines and markets. As a result, the Enforcement program must be prepared to act when necessary.

While it is difficult to identify new trends and to predict their impact on the Enforcement program, one trend that will have a definite impact is the recent dramatic growth in electronic trading on Commission-regulated markets. For example, screen-based trading has increased from five percent of the total combined volume of the U.S. futures exchanges in 1999 to 42 percent in 2003. This growth in electronic trading will pose new challenges to the Enforcement program because new types of violations (or variations on traditional violations) that are particular to electronic trading may be attempted in the future.

Trade practice investigations tend to be among the most complex and time-consuming matters undertaken by Enforcement staff and will require the commitment of significant resources for the foreseeable future. The highly resource-intensive Enron investigation and other energy-related matters are strong indications of this trend.

Domestic and International Cooperative Enforcement. On the domestic level, the Enforcement program will continue to develop relationships and share information with all regulatory and criminal authorities who may have a shared interest in particular matters. Internationally, the Enforcement program will continue to negotiate cooperative enforcement arrangements as foreign authorities obtain enhanced regulatory and enforcement powers and become full partners in investigating and prosecuting futures and option violations. Such arrangements have been critical to the investigation and prosecution of cases involving fraud and manipulation. The Enforcement program will continue to pursue opportunities to enter into such arrangements in the future and also will participate in international organizations that encourage the development of high regulatory standards and cooperative enforcement. Such organizations have had a meaningful effect on lowering the barriers to sharing information between futures regulators and encouraging foreign jurisdictions to empower their regulators to enforce futures and option laws.

Office of Proceedings

During FY 2005 and FY 2006, the Office of Proceedings will continue to hear and decide administrative enforcement cases brought by the Commission against persons or firms charged with violating the Act or Commission rules and regulations.

Office of the General Counsel

Promulgating Regulations to Ensure Sound Business, Financial, and Sales Practices. OGC will continue to draft or review all proposed and final Commission rules and rule amendments to assure their legal sufficiency and conformance with the CEA and Commission policy and precedent. In particular, OGC will continue to coordinate the Commission's work to implement the rulemakings required by the CFMA.

Financial, Capitalization, Segregation, and Supervision Violations. OGC will continue to review all enforcement recommendations and actions involving the investigation, prosecution, and sanctioning of violators of financial, capitalization, segregation, and supervision requirements to assure their legal sufficiency and conformance with the requirements of the CEA and Commission policy and precedent.

Promoting Effective Self-Regulation. OGC will continue to review all proposed SRO rules and rule amendments for legal sufficiency and conformance with Commission policy and precedent.

Facilitating a Flexible Regulatory Environment. OGC will continue to provide support to Commission efforts to coordinate and cooperate with global financial service regulators, share vital information, and develop appropriate global standards. It also will assist the Commission in promoting a flexible regulatory environment by analyzing requests for exemptions from the CEA and Commission regulations and by preparing and reviewing exemptive, no-action, and interpretive letters.

Coordination of Information and Efforts Among U.S. Regulators. OGC will continue to provide support to the efforts of Commission representatives participating in the PWG and working with other Federal regulators.

Commission Reauthorization and Other Legislative Matters. OGC will continue to monitor, review, and comment on the legal and programmatic implications of proposed legislation affecting the Commission and prepare draft legislation as requested by members of Congress or their staff. OGC also will develop and analyze legislative proposals as part of the upcoming Congressional reauthorization process.

Administrative Matters. OGC will continue to advise the Commission with respect to a wide range of administrative matters. Ongoing responsibilities will include: 1) assisting the Commission in responding to congressional inquiries; 2) advising the Commission with respect to issues involving the Freedom of Information, Privacy, Government in the Sunshine, Regulatory Flexibility, Paperwork Reduction, Small Business Paperwork Reduction, and Federal Advisory Committee Acts; 3) assisting the Commission in responding to third-party subpoenas; 4) providing support with respect to ethics issues; and 5) advising the Commission on personnel, labor, contract, and employment law matters.

Executive Direction & Support

Agency Direction. In FY 2005 and FY 2006, OIA will continue to coordinate with foreign regulatory authorities, to participate in international regulatory organizations and forums, and to provide technical assistance to foreign government authorities, in order to encourage: 1) the facilitation of cross-border transactions through the removal or lessening of any unnecessary legal or practical obstacles; 2) the development of internationally accepted regulatory standards of best practice; 3) the enhancement of international cooperation for customer and market protection; 4) the strengthening of international cooperation for customer and market protection; and 5) improvement in the quality and timeliness of international information sharing.

In FY 2005 and FY 2006, OIA will continue to participate in IOSCO, the Council of Securities Regulators of the Americas, and other international organizations to facilitate cross-border business through the elimination of unnecessary legal and practical impediments, to encourage market discipline through greater transparency, and to enhance customer and market protections through the development of cooperative arrangements and internationally accepted standards for the regulation of markets and financial services firms. During FY 2005, OIA will continue to coordinate the Commission's activities within the IOSCO Technical Committee and its standing committees with special focus on issues related to the needs of organized markets, clearing and settlement systems, and cross-border intermediation. The Commission also will continue to work within IOSCO to improve use by jurisdictions of IOSCO's assessment methodology for IOSCO's core regulatory principles and to develop standards of risk management for central counterparties and a related assessment methodology.

During FY 2005 and FY 2006, OIA will continue to: 1) provide technical assistance to foreign market authorities; 2) develop cooperative arrangements to share information needed by other regulators or SROs to register firms that are remote members of U.S. markets; and 3) continue to provide technical support for the U.S. Treasury Department's efforts in international groups, such as the Financial Stability Forum to increase the transparency of markets and strengthen the global markets' financial architecture.

Administrative Management & Support. In FY 2005, the Commission will upgrade the SPARK system to increase financial analysis capabilities and expand the scope of analysis to incorporate clearing members data. The requirement for clearing member software will be defined in FY 2005 and implementation of a solution is expected in FY 2005.

Summary of Performance Targets

Goal One: Ensure the economic vitality of the commodity futures and option markets.				
Outcome 1.1: Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.				
Annual Performance Goal: No price manipulation of other disruptive activities that would cause loss of confidence or negatively affect price discovery or risk shifting.				
Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage growth in market volume (<i>Growth in market volume</i>)	20%	24%	20%	20%
Percentage of novel or innovative market proposals or requests for CFTC action addressed within six months to accommodate new approaches to, or the expansion in, derivatives trading, enhance the price discovery process, or increase available risk management tools (<i>Expanding Infrastructure</i>)	TBD	TBD	TBD	TBD
Percentage increase in number of products traded (<i>Expanding number of products</i>)	25%	12%	9%	6%
Percentage of new exchange and clearinghouse applications completed within fast track review period	100%	100%	100%	100%
Percentage of new contract certification reviews completed within three months to identify and correct deficiencies in contract terms that make contracts susceptible to manipulation	55%	52%	50%	50%
Percentage of rule change certification reviews completed within three months, to identify and correct deficiencies in exchange rules that make contracts susceptible to manipulation or trading abuses or result in violations of law	64%	86%	75%	75%
Outcome 1.2: Markets are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.				
Annual Performance Goal: To have an effective and efficient market surveillance program.				
Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage of DCO applications demonstrating compliance with core principles	100%	100%	100%	100%
Ratio of markets surveilled per economist	8	10	11	12
Percentage of contract expirations without manipulation	99.9%	99.9%	99.9%	99.9%

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<i>Goal Two: Protect market users and the public.</i>				
Outcome 2.1: Violations of Federal commodities laws are detected and prevented.				
Annual Performance Goal: Violators have a strong probability of being detected and sanctioned.				
Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Number of enforcement investigations opened during the fiscal year	172	215	135	140
Number of enforcement cases filed during the fiscal year	64	83	65	65
Percentage of enforcement cases closed during the fiscal year in which the Commission obtained sanctions (e.g., civil monetary penalties, restitution and disgorgement, cease and desist orders, permanent injunctions, trading bans, and registration restrictions)	100%	99%	100%	100%
Cases filed by other criminal and civil law enforcement authorities during the fiscal year that included cooperative assistance from the Commission	19	20	21	23
Outcome 2.2: Commodity professionals meet high standards.				
Annual Performance Goal: No unregistered, untested, or unlicensed commodity professionals.				
Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage of SROs that comply with core principles	100%	100%	100%	100%
Percentage of DCOs that comply with core principles	100%	100%	100%	100%
Percentage of professionals complaint with standards regarding testing, licensing, and ethics training (<i>Professional compliance</i>)	93%	89%	90%	90%
Percentage of SROs that comply with requirement to enforce their rules	100%	100%	100%	100%
Percentage of total requests receiving CFTC responses for guidance and advice	100%	100%	100%	100%
Outcome 2.3: Customer complaints against persons or firms registered under the Act are handled effectively and expeditiously.				
Annual Performance Goal: Customer complaints are resolved within one year from the date filed and appeals are resolved within six months.				
Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage of filed complaints resolved within one year of the filing date	66%	41%	50%	50%
Percentage of appeals resolved within six months	50%	35%	35%	35%

Goal Three: Ensure market integrity in order to foster open, competitive, and financial sound markets.

Outcome 3.1: Clearing organizations and firms holding customer funds have sound financial practices.

Annual Performance Goal: No loss of customer funds as a result of firms' failure to adhere to regulations. No customers prevented from transferring funds from failing firms to sound firms.

Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Lost funds: a) Percentage decrease in number of customers who lose funds b) Amount of funds lost	0 \$0	0 \$0	0 \$0	0 \$0
Number of rulemakings to ensure market integrity and financially sound markets	2	4	1	1
Percentage of clearing organizations that comply with requirement to enforce rules	100%	100%	100%	100%

Outcome 3.2: Commodity futures and option markets are effectively self-regulated.

Annual Performance Goal: No loss of funds resulting from failure of self-regulated organizations to ensure compliance with their rules.

Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage of intermediaries who meet risk-based capital requirements	100%	100%	100%	100%
Percentage of clearing organizations that comply with requirement to enforce their rules	100%	100%	100%	100%

Outcome 3.3: Markets are free of trade practice abuses.

Annual Performance Goal: Minimize trade practice abuses.

Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage of exchanges deemed to have adequate systems for detecting trade practice abuses	100%	100%	100%	100%
Percentage of exchanges that comply with requirement to enforce their rules	100%	100%	100%	100%

Outcome 3.4: Regulatory environment is flexible and responsive to evolving market conditions.

Annual Performance Goal: TBD

Performance Measures	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2006 Plan
Percentage of CFMA Section 126(b) objectives implemented	100%	100%	100%	100%
Number of rulemakings, studies, interpretations, and guidance to ensure market integrity and exchanges' compliance with regulatory requirements	5	8	6	6
Percentage of requests for no-action or other relief completed within six months related to novel market or trading practices and issues to facilitate innovation	100%	100%	100%	100%
Percentage of total requests receiving CFTC responses for guidance and advice	100%	100%	100%	100%

Justification of the FY 2006 Budget & Performance Estimate

Breakout of \$99.4 Million Budget Estimate by Program

	FY 2004		FY 2005		FY 2006 Current Svcs.		FY 2006 Request	
	FTE	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE	\$ (000)
Market Oversight	105	\$17,497	99	\$17,354	99	\$18,497	99	\$18,497
Clearing & Intermediary Oversight	70	\$11,876	62	\$11,580	62	\$12,325	62	\$12,325
Chief Economist	9	\$1,544	9	\$1,725	9	\$1,828	9	\$1,828
Enforcement	155	\$25,343	139	\$27,923	139	\$29,565	139	\$29,565
Proceedings	14	\$2,445	14	\$2,518	14	\$2,677	14	\$2,677
General Counsel	30	\$5,857	31	\$6,193	31	\$6,583	31	\$6,583
Exec. Direction & Support	143	\$25,368	137	\$26,280	137	\$27,911	137	\$27,911
Total	526	\$89,930	491	\$93,573	491	\$99,386	491	\$99,386

FY 2006 President's Budget & Performance Estimate

Breakout of \$99.4 Million Budget Estimate by Object Class

	FY 2004	FY 2005	FY 2006
	<u>(\$000)</u>	<u>(\$000)</u>	<u>(\$000)</u>
11.1 Full-Time Perm. Compensation	\$53,110	\$53,906	\$55,844
11.3 Other Than Perm. Compensation	30	30	30
11.5 Other Personnel Compensation	71	1,225	1,381
11.8 Special Pers. Serv. Payments	<u>5</u>	<u>18</u>	<u>18</u>
11.9 Subtotal, Personnel Comp.	53,216	55,179	57,273
12.1 Personnel Benefits: Civilian	12,802	13,741	14,402
13.0 Benefits for Former Personnel	61	33	33
21.0 Travel & Transportation of Persons	875	1,171	1,308
22.0 Transportation of Things	60	68	70
23.2 Rental Payments to Others	10,180	10,595	11,279
23.3 Comm., Utilities & Miscellaneous	2,447	2,501	2,755
24.0 Printing and Reproduction	259	235	235
25.0 Other Services	6,346	6,976	8,288
26.0 Supplies and Materials	725	706	733
31.0 Equipment	2,547	2,308	2,917
32.0 Building/Fixed Equipment	122	0	93
42.0 Claims/Indemnities	<u>253</u>	<u>60</u>	<u>0</u>
99.0 Subtotal, Direct Obligations	89,893	93,573	99,386
99.0 Reimbursable	<u>37</u>	<u>100</u>	<u>100</u>
99.0 Total Obligations	<u>\$89,930</u>	<u>\$93,673</u>	<u>\$99,486</u>

FY 2006 President's Budget & Performance Estimate

Crosswalk from FY 2005 to FY 2006

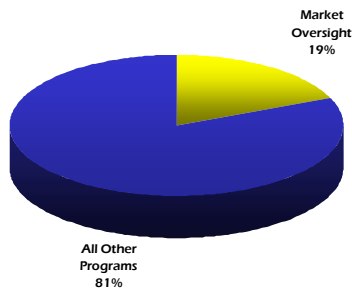
	FY 2005 Estimate	FY 2006 Request	Change
Budget Authority (\$000)	\$93,573	\$99,386	\$5,813
Full-Time Equivalents (FTEs)	491	491	0

<u>Explanation of Change</u>	<u>FTEs</u>	<u>Dollars (\$000)</u>
Increases: (Adjustments to FY 2005 Base)		
To provide for the following changes in personnel compensation (excluding benefits):		
-- Estimated April 2005 3.5% pay increase (annualization of)		1,038
-- Estimated April 2006 2.3% pay increase		572
-- Within-grade increases		330
-- Other Personnel Services		156
To provide for increased costs of personnel benefits		661
To provide for the following changes in non-personnel costs:		3,056
-- Travel (\$139)		
-- Space Rental (\$684)		
-- Communications/Utilities (\$254)		
-- Supplies/Printing (\$27)		
-- All Services (\$1,312)		
-- Equipment (\$698)		
-- Claims/Indemnities (-\$58)		
Total Increases	+0	\$5,813

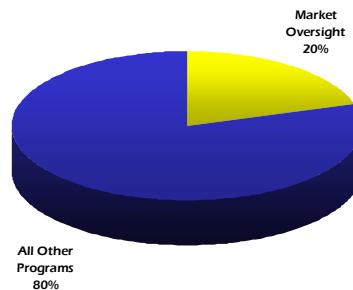
Table 1: Crosswalk from FY 2005 to FY 2006

Market Oversight

Total Budget:	\$ 18,497,000	99 FTEs
Total Change:	\$ 1,143,000	0 FTE



**Figure 9: Market Oversight
Percentage of Total Budget Dollars**



**Figure 10: Market Oversight
Percentage of Total Budget FTEs**

Justification of the FY 2006 President's Budget & Performance Estimate

The primary responsibility of the Market Oversight program is to foster markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity. By detecting and protecting against price manipulation and abusive trading practices, this program assists the markets in performing the vital economic functions of price discovery and risk transfer (hedging). The Market Oversight program will initiate and carry out the Commission's surveillance and oversight programs for these markets. The program also will conduct trade practice surveillance and reviews of exchange rule amendments and submissions. In addition, the program will develop, implement, and interpret regulations that protect customers, prevent trading abuses, and assure the integrity of the futures markets.

In FY 2006, the Market Oversight program level of 99 FTEs would maintain staffing at the same level as the FY 2005 level. The three subprograms—Market Surveillance, Market and Product Review, and Market Compliance—are requesting 50 FTEs, 15 FTEs, and 34 FTEs, respectively.

Market Surveillance. Futures prices are generally quoted and disseminated throughout the U.S. and abroad. Business, agricultural, and financial enterprises use the futures markets for pricing information and for hedging against price risk. The participants in commercial transactions rely extensively on prices established by the futures markets, which affect trillions of dollars in commercial activity. Moreover, the prices established by the futures markets directly or indirectly affect all Americans. They affect what Americans pay for food, clothing, and shelter, as well as other necessities. Since futures and option prices are susceptible to manipulation and excessive volatility and since producers and users of the underlying commodities can be harmed by manipulated prices, preventive measures are necessary to ensure that market prices accurately reflect supply and demand conditions.

Actions to detect and prevent price manipulation are taken by economists who monitor all active futures and option contracts for potential problems. The FTEs requested for the Market Oversight will work on investigating possible manipula-

tion and other trading abuses, analyze routine reports of large trader activity, conduct rule enforcement reviews, and work to detect and prevent threats of price manipulation or other major market disruptions caused by abusive trading practices. This involves:

- Analyzing the activities of large traders, key price relationships, and relevant supply and demand conditions for an anticipated 600 futures and option contracts representing major agricultural commodities, metals, energy, financial instruments, equity indices, foreign currencies, and security futures products; and
- Preparing reports on special market situations and weekly reports on market conditions for contracts approaching their critical expiration periods. Potential problems are discussed weekly with the Commissioners and senior staff. The Commission and the affected exchange, jointly in most cases, develop and administer any necessary responsive measures. The Commission shares pertinent information with other regulatory agencies.

Price manipulation prevention activities of Market Surveillance economists are enhanced by support personnel; such as futures trading specialists, futures trading assistants, and statisticians. Their activities include:

- Operating an extensive daily data-gathering and verification system and collecting reports from exchanges, futures industry firms, and traders. The reports provide current market information on the size of futures and option positions held by large traders as well as other background information that is necessary to enforce Commission and exchange speculative limits;
- Providing software development and statistical support to quantify and display important relationships between key economic variables; and
- Improving the effectiveness and efficiency of the large trader reporting system.

Market and Product Review. In order to serve the vital price-discovery and hedging functions of futures and option markets, exchanges must provide consumers safe marketplaces that have appropriate protections in place and provisions for ensuring the fairness of the market and the integrity of contracts traded. Exchanges must list products for trading that are not readily susceptible to manipulation and do not lead to price distortions or disruptions in the futures or option markets and in the underlying cash markets. Adherence to the approval criteria, core principles, and appropriate contract design minimizes market disruptions and the susceptibility of the contracts to manipulation or price distortion.

The Market and Product Review subprogram, in cooperation with other offices of the Commission, reviews exchanges' applications for approval as a contract market or as a DTEF to ensure that the exchange is in compliance with approval criteria and core principles and Commission regulations. The subprogram also reviews filings by exempt markets and, on an ongoing basis, reviews these entities to ascertain whether they comply with statutory requirements.

The subprogram reviews requests from exchanges for approval of new contracts and rule amendments to existing contracts to ensure that contracts are in compliance with statutory and regulatory anti-manipulation requirements. It also conducts reviews of new products and rule changes of economic significance submitted under certification procedures to provide information about the markets and product design features to ensure that contracts and rules comply with statutory requirements as well as the Commission's rules and policies. The reviews foster markets free of

disruptions or price manipulation and provide essential information to conduct effective market surveillance and address regulatory and public interest issues. In this regard, deficiencies in the terms and conditions of futures and option contracts increase the likelihood of cash, futures, or option market disruptions and decrease the economic usefulness and efficiency of contracts.

In cooperation with other Commission staff, Market and Product Review staff reviews the Commission's rules and policies related to oversight of regulated and exempt markets and products to ensure that the Commission's regulatory subprogram is achieving Commission goals and does not hinder innovation. Together with OIA as members of international working groups, the subprogram works with foreign regulatory bodies as members of international working groups to provide assistance and expertise about futures and option trading, product design, surveillance, and the regulation of derivatives markets. The subprogram also provides support to the Enforcement program in the form of economic analyses in connection with manipulation cases or other violations of commodity laws.

The Market and Product Review subprogram also reviews exchange rule submissions with a view toward: 1) maintaining the fairness and financial integrity of the markets; 2) protecting customers; 3) accommodating and fostering innovation; and 4) increasing efficiency in self-regulation consistent with statutory mandates. These rule submissions often present complex new trading procedures and market structures as well as financial arrangements that raise novel issues.

Market Compliance. The Market Compliance subprogram oversees the compliance activities of all designated contract markets in furtherance of the Commission's primary goals of ensuring customer protection and market integrity. The oversight program consists of examinations of exchange self-regulatory programs on an ongoing, routine basis to assess their continuing compliance with applicable core principles under the Act and the Commission's regulations. The examinations result in rule enforcement review reports that evaluate an exchange's, compliance and surveillance capabilities. The reports set forth recommendations for improvement where appropriate with respect to an exchange's trade practice surveillance, market surveillance, disciplinary, audit trail, record-keeping, and governance programs. These periodic reviews promote and enhance continuing effective self-regulation and ensure that exchanges rigorously enforce compliance with their rules.

The Market Compliance subprogram also monitors trading activity on all exchanges in order to detect and prevent possible trading violations. This type of oversight is conducted through the use of automated surveillance and floor surveillance, and it fosters markets that are free of trading abuses. The identification of potential trading violations results in referrals to relevant exchanges and to the Commission's Division of Enforcement. In addition, the Market Compliance subprogram reviews and analyzes proposed exchange trading platforms, rule enforcement programs, and disciplinary procedures in conjunction with new designated contract market applications. The subprogram also conducts special studies of exchange rules, procedures, and trading practices as issues arise affecting a particular exchange. This serves to promote orderly trading and facilitates open and competitive markets.

Impact of Requested Level of Resources

The growth in the number and different types of facilities that trade a wider array of derivatives products, including single-stock futures, futures on over-the-counter instruments, contracts based on events or occurrences and novel approaches to derivatives trading, requires an increased and more sophisticated level of surveillance, data collection, analysis, reporting, and research to conduct

effective oversight and develop the necessary expertise to monitor these developments. Surveillance and oversight of exchanges and product design involves monitoring an increasing number of innovative and often complex futures and option contracts to detect or prevent potential problems, price manipulation, and other major market disruptions caused by abusive trading practices of contract design flaws.

In FY 2006, the Market Oversight staff will be required to monitor a large and diverse array of markets and will continue to carry out the Commission's program of surveillance and oversight of single-stock futures. The Commission anticipates that a large number of new contracts will be listed for trading, both on futures and securities exchanges, and that options on security futures products may also be trading. The number of energy futures contracts is also expected to continue to grow. Also, exchanges have indicated an interest in listing a large number of contracts based on events that raise core issues regarding the extent of the Commission's jurisdiction.

At the requested level, the Market Oversight program will continue to conduct surveillance and exchange oversight. However, the level of oversight will not be commensurate with the growth in new types of exchanges and the initiation of trading in new products. Thus, the staff will be less able to detect and prevent price manipulation and abusive trading practices in all of the existing and new markets. Staff will continue to conduct due diligence reviews of new contracts and rule filings to ensure that they comply with all statutory and regulatory requirements. However completion of the review would be delayed so that potential violations would take longer to be addressed. At this level of FTE commitment, there will have to be some shifting of attention from markets that are less susceptible to market disruption, and toward both the new markets and the established markets that are more susceptible to disruption.

In addition, at the requested level, the staff would conduct reviews of applications by entities seeking to become an approved futures exchange within the 180-day statutory time frame. However, staff likely would not be able to process all of those applications under the Commission's fast-track procedures. The staff also will review filings by exempt markets, but may not be able to quickly respond to industry questions about those filings.

At the requested level, the staff would attempt to monitor developments in derivatives trading and market innovations, as innovations in technology and derivative instruments and trading methods in futures markets create many challenging economic and regulatory issues. However, the reviews and studies may take longer to complete and may affect the staff's ability to ensure that the Commission has in place sound regulatory policies to reduce systemic risk in financial markets and protect the economic function of the market without undermining innovation and the development of new approaches to risk management.

Finally, at the requested level, staff should be able to conduct rule enforcement review examinations at the same number of exchanges as it did in FY 2005. However, the effectiveness of the Commission's oversight program for assessing the adequacy of exchange compliance programs could be diminished. Staff will not be able to review the compliance capabilities of the ever-growing number of newly-designated contract markets or some existing contract markets on a timely basis. Timely review of these programs is necessary to ensure that exchanges are rigorously monitoring their markets for potential trading abuses and aggressively enforcing their rules by imposing meaningful penalties on wrongdoers.

Consequence of Not Receiving Requested Level of Resources

If the Commission does not receive the resources requested for its Market Oversight program for FY 2006, the level of surveillance, exchange oversight, contract designation reviews, and studies to enhance understanding of the markets will not be commensurate with the growth in new types of exchanges, new trading execution methods in futures markets, and the initiation of trading in new innovative complex products that require detailed analysis and raise substantive legal and policy questions. Thus, some price manipulations and abusive trading practices may go completely undetected or detected too late to permit amelioration or intervention. Further, the efficacy of some exchange self-regulatory programs may not be evaluated on a timely basis. As a result, staff will not be able to ensure fully that exchanges are effectively fulfilling their self-regulatory responsibilities with respect to customer protection and market integrity, and customer orders may suffer direct economic harm from an increase in illegal trading activity.

In addition, staff would not be able to review all new contract and rule change submissions for approval within statutory time frames. This could result in direct economic harm to producers and other users of the underlying commodities and indirect harm to the economy as a whole since market prices may not accurately reflect supply and demand conditions.

Also, staff would not be able to provide timely guidance to entities seeking to become approved exchanges, and to existing exchanges and other interested parties with questions related to Commission jurisdiction over novel products or practices or the compliance of specific proposals with statutory and regulatory standards. This may undermine innovation and reduce competition by increasing legal uncertainty about products or practices, and likely would delay the launch of the new exchanges, products, and trading procedures. Similarly, staff's disposition of requests for no-action relief, including requests by foreign exchanges to place trading terminals in the U.S., would likely be slowed and, thus, delay the ability of industry participants to timely implement their business plans.

FY 2006 President's Budget & Performance Estimate

Table 2: Market Oversight Request by Subprogram

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Market Operations	\$5,872	34.00	\$6,281	34.00	\$409	0.00
Product Review & Analysis	3,617	15.00	3,837	15.00	220	0.00
Market Surveillance	7,865	50.00	8,379	50.00	514	0.00
TOTAL	\$17,354	99.00	\$18,497	99.00	\$1,143	0.00

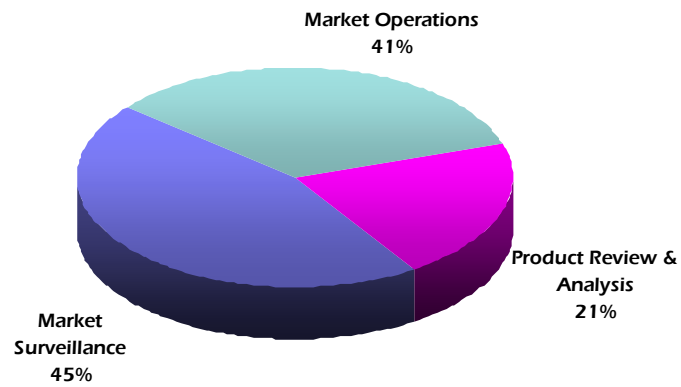


Figure 11: Market Oversight FY 2006 Budget by Subprogram

FY 2006 President's Budget & Performance Estimate

Table 3: Market Oversight Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$10,427	61.00	\$11,102	61.00	\$675	0.00
1.2 Markets that can be monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.	1,211	6.00	1,287	6.00	76	0.00
Subtotal Goal One	\$11,638	67.00	\$12,389	67.00	\$751	0.00
GOAL TWO: Protect market users and the public.						
None						
GOAL THREE: Foster open, competitive, and financially sound markets.						
Outcomes						
3.2 Commodity futures and option markets are effectively self-regulated.	\$3,921	22.00	\$4,189	22.00	\$268	0.00
3.3 Markets are free of trade practice abuses.	1,554	9.00	1,664	9.00	110	0.00
3.4 Regulatory environment responsive to evolving market conditions.	241	1.00	256	1.00	15	0.00
Subtotal Goal Three	\$5,716	32.00	\$6,109	32.00	\$393	0.00
TOTAL	\$17,354	99.00	\$18,498	99.00	\$1,144	0.00

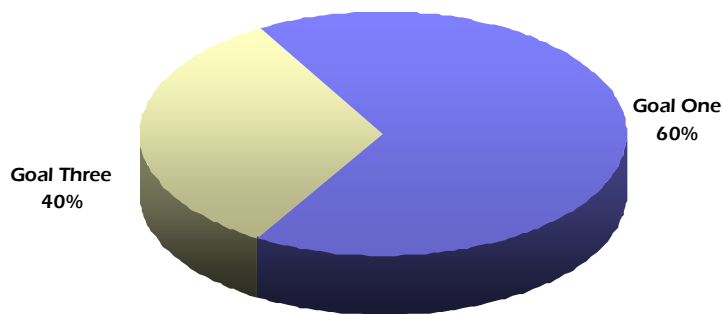


Figure 12: Market Oversight FY 2006 Budget by Goal

Clearing & Intermediary Oversight

Total Budget: \$12,325,000 **62 FTEs**
Total Change: \$745,000 **0 FTE**

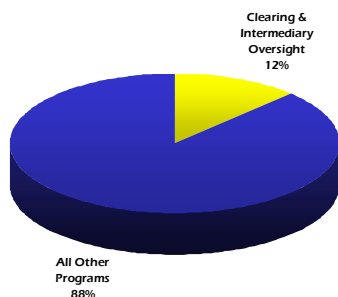


Figure 13: Clearing & Intermediary Oversight Percentage of Total Budget Dollars

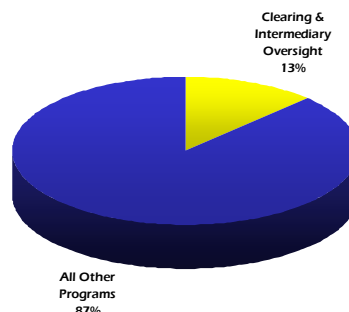


Figure 14: Clearing & Intermediary Oversight Percentage of Total Budget FTEs

Justification of the FY 2006 President's Budget & Performance Estimate

In FY 2006, the Clearing and Intermediary Oversight program level of 62 FTEs would maintain staffing at the same level as the FY 2005 level. A lower level would not permit the Clearing and Intermediary Oversight program to meet established responsibilities as well as the additional responsibilities directed by Congress through the CFMA.

The Act, as amended in December 2000 by the CFMA, contemplates a system of flexible yet effective self-regulation and sets forth several purposes of the Act:

- To deter and prevent price manipulation or any other disruptions to market integrity;
- To ensure the financial integrity of all transactions subject to the Act and the avoidance of systemic risk; and
- To protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets.

The futures markets have grown rapidly since passage of the Commodity Futures Modernization Act, with the trading volume expected in 2006 to be twice that of 2000 when the Act was passed. Then, there were 12 U.S. futures exchanges but now there are 20 designated contract markets and another 13 trading platforms covered by the Act, so that the number of markets subject to some level of Commission oversight has tripled. Similarly, more than 600 new products have been brought online since 2000 versus fewer than 200 in the three years preceding the Act's passage. These are very positive developments for market users but they seriously challenge the supervisory resources of the Commission.

Of particular relevance to the Clearing and Intermediary Oversight program are designated derivatives clearing organizations (DCOs), over which the Commission was for the first time assigned direct supervisory responsibility by the CFMA. Since 2000, seven clearinghouses have been designated, three of which were completely new institutions and another of which is an overseas institution.

Clearinghouses, as the central counterparties in the futures markets, are key to the financial integrity of those markets by removing counterparty credit risk exposures for participants. Their proper supervision requires the Commission to devote substantial resources to developing new competencies and implementing new oversight programs.

The Clearing and Intermediary Oversight program is responsible for:

- Oversight of market intermediaries to monitor their financial integrity, risk management capabilities, protection of customer funds, and compliance with appropriate sales practice standards for the protection of customers and the public;
- Oversight of non-DCO SROs to ensure their fulfillment of responsibilities for monitoring and ensuring the financial integrity of market intermediaries, ensuring their compliance with appropriate sales practice standards for the protection of customers and the public, and for the protection of customer funds;
- Oversight of DCOs to monitor their operations for compliance with core principles, including their financial resources, risk management, default procedures, protections for customer funds, and system safeguards;
- Review of applications for registration as DCOs and DCO rule submissions and oversight of DCOs for continued compliance with core principles, including maintenance of appropriate risk management capabilities;
- Oversight of the registration and fitness review of market intermediaries through review of the NFA, an RFA authorized to receive, review, and process intermediary applications for registration;
- Development of rules to protect market users and financial intermediaries, including requirements related to registration, fitness, financial adequacy, risk management capabilities, sales practice activities, the protection of customer funds, and clearance and settlement activities;
- Developing audit standards and programs for and monitoring compliance by FCMs, IBs, CPOs, and CTA with rules implementing the anti-money laundering provisions of the USA Patriot Act;
- Stock-index margin reviews; and
- Oversight of foreign market access by intermediaries.

Compliance and Registration. A Compliance and Registration subprogram level of 13 FTEs in FY 2006 would represent the same level of staffing as the FY 2005 level. A lower level would not enable the Compliance and Registration subprogram to address its current and anticipated additional responsibilities in a satisfactory manner.

The Compliance and Registration subprogram is responsible for providing policy advice and recommendations to the Commission, other staff units, the public, and the industry concerning the activities of futures industry intermediaries with respect to, among other things, registration, disclosure, sales practices, and record-keeping. The subprogram is engaged in an ongoing regulatory modernization effort to keep the Commission's regulatory framework abreast of market developments. This permits the Commission and the subprogram to provide rules and interpretations that are flexible, effective, and efficient and allow for further

FY 2006 President's Budget & Performance Estimate

industry innovation and enhancements. In response to changes in the business environment for futures intermediaries, the subprogram makes policy recommendations to the Commission regarding intermediaries and develops rules and interpretations to implement the Commission's policies. Subprogram staff work closely with the staff of NFA, other RFAs, and other industry groups to effectively address issues that arise in connection with the business practices of intermediaries.

More specifically, in FY 2006, the ongoing responsibilities of the Compliance and Registration subprogram will include: 1) addressing regulatory issues and implementing a regulatory modernization program for intermediaries; 2) conducting oversight of, and working with the Enforcement program concerning, firms engaged in retail off-exchange foreign currency transactions; 3) assisting in the Commission's participation with the Treasury Department and other financial regulators to develop rules to implement the anti-money laundering of the USA Patriot Act; and 4) overseeing an increased number of RFAs. It is also expected that the Compliance and Registration subprogram will continue to coordinate with the SEC with respect to the trading of security futures products. Among other things, subprogram staff will participate in addressing issues related to trading of foreign security futures products and foreign index products by U.S. customers.

The responsibilities of the Compliance and Registration subprogram further include assuring that clearing organizations, firms holding customer funds, and other professionals are able to compete in dynamically evolving markets without sacrificing customer protections. Rapid market and product evolution will require that existing rules be reviewed, refined, and applied in a manner that facilitates competitiveness while preserving core customer and market safeguards. The globalization of the markets, the blurring of distinctions among financial institutions, and the explosive growth of technology have made it essential that the Commission adapt its rules continually and appropriately to market conditions.

As advances in information technology increasingly free markets from geographic and time-of-day constraints, resources must be allocated to reviewing and monitoring trading systems that originate both inside and outside the U.S. and that are available electronically around the world and around the clock for their impact on intermediaries. The subprogram develops rules and responds to inquiries from market professionals and the public concerning the impact of these systems on futures intermediaries. Further, as other sectors of the global economy continue the process of deregulation, there will be new risks and increasing competition in those sectors among producers and consumers and a concomitant need to develop innovative price discovery and hedging instruments. Staff of this subprogram review and monitor systems developed to address these needs, particularly in an off-exchange environment and with respect to the impact on intermediaries. They also evaluate other off-exchange products and new types of trading mechanisms.

Compliance and Registration subprogram staff will continue to review the Commission's Part 30 rules, which govern the trading of persons located in the U.S. on futures markets located outside of the U.S., to assure that the Commission provides a flexible structure that maintains opportunities for U.S. competitiveness in a growing global marketplace.

Audit and Financial Review. An Audit and Financial Review subprogram level of 41 FTEs in FY 2006 would represent the same level of staffing as the FY 2005 level. A lower level would not enable the Audit and Financial Review subprogram to address its current and anticipated additional responsibilities in a satisfactory manner.

The Audit and Financial Review subprogram has responsibility for ensuring the adequacy, reliability, and resilience of safeguards in the clearing system (consisting of both clearinghouses and FCMs) designed to protect against: 1) the financial problems of a single market participant becoming systemic problems that could affect other market participants or other markets; 2) customer funds being misused or exposed to inappropriate risks of loss; and 3) abusive sales practices that harm customers and undermine market integrity. The subprogram is also responsible for conducting ongoing financial surveillance of firms and clearinghouses to detect, prevent, and respond to potential sources of systemic financial risk. Finally, the subprogram encompasses the Office of Chief Accountant, which is responsible for, among other things, developing and interpreting Commission's rules in such areas as minimum capital requirements for futures firms.

The Audit and Financial Review subprogram is responsible for ensuring that clearinghouses and futures firms are adequately capitalized, have in place appropriate risk management systems and procedures, and are operationally capable and resilient (even in the event of internal or external disasters) to perform their crucial role as the first line of defense against systemic problems. The subprogram also is responsible for verifying that industry SROs are fulfilling their responsibilities with respect to the futures firms and other market intermediaries over whom they have direct oversight. This direct oversight is an important next line of defense in protecting customers, customer funds, and market integrity. The subprogram is also responsible for ensuring that clearinghouses are adequately capitalized, effectively organized and properly managed, appropriately resourced in all functional areas, particularly with respect to risk management, and operationally resilient so that they can serve their critically important role as the ultimate defense against systemic risks in the marketplace.

The subprogram staff will accomplish this through monitoring the financial integrity, risk management capabilities, protection of customer funds, systems safeguards, default procedures, rule enforcement efforts, and compliance with appropriate sales practice standards of market intermediaries and SROs. Toward this end, the subprogram staff will also review applications for registration as DCOs, DCO rule submissions, and oversight of DCOs for continued compliance with core principles, including maintenance of appropriate risk management capabilities.

The proliferation of new and innovative derivative contracts require the Commission to explore measures that remove artificial barriers to competition while continuing to ensure that the goals of systemic financial integrity, individual registrant integrity, and customer protection are met. As the Commission continues moving from a direct regulatory posture to an oversight posture, such capacity will be critical, and the increase in staff resources is necessary to achieve this outcome.

The subprogram staff will continue to explore technological advancements that will provide for more efficient monitoring of the financial condition of the markets and market participants. In this area, the Financial Surveillance unit, one of two new units within the subprogram, was created during FY 2004 to enhance and expand the Division's utilization of automated tools and systems to gather, combine, and analyze information from monthly financial reports filed by FCMs,

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large trader position information, and other relevant market and financial information so as to provide ongoing surveillance of actual or potential financial risks facing firms and clearinghouses and to anticipate emerging problems that may pose systemic risks.

Another subprogram priority is the conduct of comprehensive oversight programs for clearinghouses and other SROs. Similar to the approach of other federal financial regulators and certain overseas financial supervisors, indeed, in close consultation with several such peers - the subprogram has begun to enhance its supervision of exchanges, clearinghouses, and other self-regulatory organizations with risk-based examination cycles and risk-focused reviews. Both the scheduling and scope of the subprogram's supervisory reviews will now be based on careful analysis of the underlying risks to which an institution is exposed and the controls which it has in place to address those risks. This approach promises to better utilize supervisory resources and to help ensure even greater financial integrity and risk management within the firms and clearinghouses that are the backbone of the futures clearing system. The Major Reviews unit, one of two new units within the subprogram, was created during FY 2004 to plan, coordinate, schedule, monitor, and assess major risk-focused reviews so as to ensure that multiple, simultaneous major reviews are completed on schedule, follow appropriate benchmarks of consistency and comparability, and, ultimately, provide meaningful assessments of core principle compliance which, when presented formally to the Commission, permit the Commissioners to assure themselves that the Commission is fulfilling its responsibilities on this important aspect of market oversight.

Carrying out the regulation and review of broad-based stock-index futures and security futures product margin is another responsibility of the Audit and Financial Review subprogram. The increase in resources also will allow subprogram staff to monitor the financial integrity of individual registrants and the markets generally and to improve SRO oversight programs.

To maintain the effectiveness of its oversight in the face of increasing technological, competitive, and other changes in the markets, the DCIO has recently organized two new formal functional units, which will have to be staffed from within using existing human resources.

- **Major Reviews.** Staff of this unit will work with the Deputy Director, Chief Accountant/Associate Deputy Director, and regional Branch Chiefs to plan, coordinate, schedule, monitor, and assess the major risk-focused reviews that DCIO performs of SROs and DCOs. This includes ensuring compliance by Commission registrants with requirements in areas of net capital, segregation of customer funds, financial disclosure, sales practices, anti-money laundering, and related record keeping and reporting requirements. An important aspect of these new positions is the enhanced capability that DCIO will acquire to ensure that, where staff resources permit, multiple, simultaneous major reviews can be completed on schedule, follow appropriate benchmarks of consistency and comparability, and provide meaningful assessments of compliance with core principles that assure the Commission is fulfilling its oversight responsibilities.
- **Financial Surveillance.** Staff of this unit will perform the Assistant Director for Financial Surveillance function. The Assistant Director is responsible for leading a team that conducts the Division's enhanced financial surveillance function, which includes the monitoring of market information, evaluating the impact of market moves on the financial integrity of market participants, and anticipating and acting upon indications of financial difficulty, including communicating relevant information to other divisions, the Commission, and

the clearing and SRO communities. The financial surveillance function will utilize automated systems and financial surveillance software, some of it internally developed, including RSR Express, SPARK, and SPAN Risk Manager to monitor FCMs and large traders, and the financial exposures they generate. These staff also will communicate with DCIO and other Commission staff to identify, analyze, and follow up on potential financial difficulties arising with a large trader, FCM, exchange, or DCO.

Clearing Policy. A Clearing Policy subprogram level of eight FTEs in FY 2006 would represent the same level of staffing as the FY 2005 level. A lower level would not enable the Clearing Policy subprogram to address its current and anticipated additional responsibilities in a satisfactory manner.

The Clearing Policy subprogram is responsible for providing policy advice and recommendations to the Commission, other staff units, the public, and the industry concerning clearing. In particular, the subprogram staff: 1) develop rules and rule amendments applicable to derivatives clearing organizations and intermediaries including matters such as financial resources, participant and product eligibility, treatment of funds, reporting, record-keeping, public information, and bankruptcy; 2) prepare responses to no-action, exemption and interpretative requests on any program activities; 3) review and make recommendations concerning applications for registration as a DCO; 4) review and make recommendations concerning DCO rule submissions; and 5) review and make recommendations concerning exchange or registered futures associations' rules that implicate clearing, treatment of funds, or similar issues.

The level of staffing requested for the Clearing Policy subprogram is needed to keep pace with the ongoing developments in the industry as they relate to clearing. These developments concern applications by foreign entities to become registered as DCOs; links between domestic DCOs and foreign clearinghouses; participation by foreign firms as clearing members of domestic DCOs; deposit of customer funds in offshore locations; clearing of OTC products by DCOs; cross-margining of products by DCOs and other clearinghouses; and the investment of customer funds in a wider range of instruments.

The CFMA further authorizes DCOs to clear OTC transactions. Commission rules provide that applicants for DCO registration are deemed registered 60 days after submission of the application unless notified otherwise. Therefore, these applications require immediate attention from program staff who are experienced and knowledgeable in DCO operations. The requested level of staffing is necessary for coverage in this area. Moreover, globalization of the markets has led to proposals for intermarket clearing links. Such proposals raise novel and complex issues regarding such topics as treatment of funds and bankruptcy implications.

Impact of Requested Level of Resources

The Clearing and Intermediary Oversight program must maintain an effective supervisory system that is responsive to technological development, business changes, increasing globalization, and other evolutionary changes in the markets and the clearing process. The level of resources requested is necessary for the Clearing and Intermediary Oversight program to meet the responsibilities assigned to it by Congress through the CFMA and any further changes to the CEA resulting from the Commission's reauthorization in 2005, including oversight of (and coordination with the Division of Enforcement concerning) retail off-exchange foreign currency transactions, and to help keep pace with the rapid growth in futures and option trading volume and the profound changes resulting from global competition, innovation in derivative contracts, new clearing organizations, advances in technology, and new market practices. The program also is

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responsible for ensuring that Commission registrants comply with the requirements of the USA PATRIOT Act.

The level of resources requested is necessary for the Clearing and Intermediary Oversight program to provide appropriate guidance to industry professionals, customers, RFAs, and other market users regarding compliance with an increasingly changing business and regulatory environment as promptly and effectively as possible, which will facilitate innovation and market growth and improve the environment for the international competitiveness of U.S.-based clearing organizations.

Consequences of Not Receiving Requested Level of Resources

If the requested level of resources is not received, the Clearing and Intermediary Oversight program will be less able to promptly implement and maintain an effective regulatory system to fulfill its increased responsibilities under the CFMA and any further changes to the CEA resulting from the Commission's reauthorization in 2005. Without adequate levels of staffing, the Clearing and Intermediary Oversight program will be less capable of meeting its responsibilities concerning the registration of DCOs and RFAs, the oversight of the operations and activities of DCOs and SROs, and enforcement of compliance by DCOs and SROs with core principles and other provisions of the CEA and Commission rules. Fewer resources also would impair the program's ability to carry out activities for the oversight and review of broad-based stock-index futures and security futures product margins. In addition, failure to achieve the requested staffing levels could adversely affect the program's efforts to monitor compliance with anti-money laundering provisions of the USA PATRIOT Act.

An insufficient level of resources also would hinder the ability of the program to provide guidance on complying with an ever-changing business and regulatory environment characterized by new products and increasing numbers of new market participants. Not responding promptly to these inquiries could delay innovation and restrict market growth, and it may burden the international competitiveness of U.S.-based clearing organizations and intermediaries with regulatory inefficiencies and outmoded regulatory structures.

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Table 4: Clearing & Intermediary Oversight Request by Subprogram

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Compliance & Registration	\$2,796	13.00	\$2,990	13.00	\$194	0.00
Audit & Financial Review	8,784	49.00	9,335	49.00	551	0.00
TOTAL	\$11,580	62.00	\$12,325	62.00	\$745	0.00

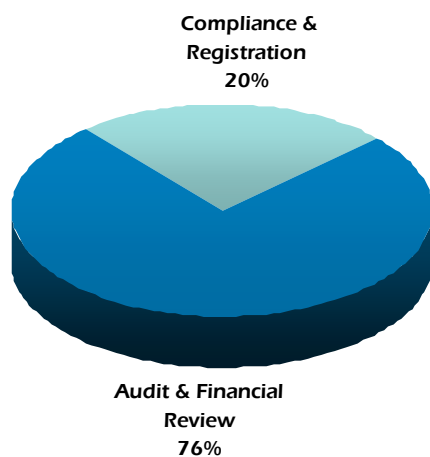


Figure 15: Clearing & Intermediary Oversight FY 2006 Budget by Subprogram

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Table 5: Clearing & Intermediary Oversight Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$269	1.50	\$286	1.50	\$17	0.00
1.2 Markets that can be monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.	269	1.50	286	1.50	\$17	0.00
Subtotal Goal One	\$538	3.00	\$572	3.00	\$34	0.00
GOAL TWO: Protect market users and the public.						
Outcomes						
2.1 Violations of Federal commodities laws are detected and prevented.	\$914	5.00	\$972	5.00	\$58	0.00
2.2 Commodities professionals meet high standards.	3,979	20.50	4,241	20.50	262	0.00
Subtotal Goal Two	\$4,893	25.50	\$5,213	25.50	\$320	0.00
GOAL THREE: Foster open, competitive, and financially sound markets.						
Outcomes						
3.1 Clearing organizations and firms holding customer funds have sound financial practices.	\$1,560	8.50	1,660	8.50	\$100	0.00
3.2 Commodity futures and option markets are effectively self-regulated.	3,496	19.50	3,715	19.50	219	0.00
3.4 Regulatory environment responsive to evolving market conditions.	1,092	5.50	1,166	5.50	74	0.00
Subtotal Goal Three	\$6,148	33.50	\$6,541	33.50	\$393	0.00
TOTAL	\$11,579	62.00	\$12,326	62.00	\$747	0.00

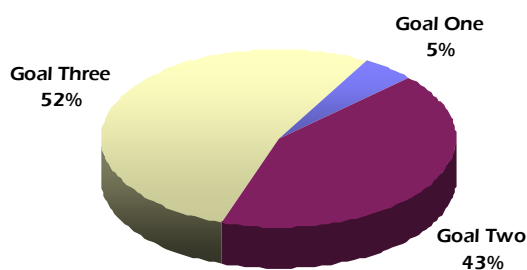


Figure 16: Clearing & Intermediary Oversight FY 2006 Budget by Goal

Enforcement

Total Budget: \$29,565,000

139 FTEs

Total Change: \$ 1,642,000

0 FTE

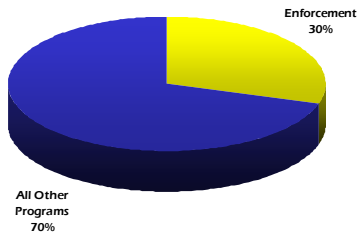


Figure 17: Enforcement Percentage of Total Budget Dollars

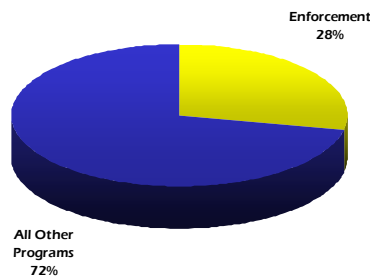


Figure 18: Enforcement Percentage of Total Budget FTEs

Justification of the FY 2006 President's Budget & Performance Estimate

The primary responsibility of the Enforcement program is to police for conduct that violates the CEA and Commission regulations. Such conduct undermines the integrity of the market and the confidence of market participants.

In FY 2006, the Enforcement program level of 139 FTEs would maintain staffing at the same level as the FY 2005 level. This level of FTEs is vitally needed by the Enforcement program to address the following developments:

- Trading strategies have become more complex, crossing product lines and markets, which has required the Enforcement program to expand the scope of its investigations concerning fraud, market manipulation, and other abusive trading practices. A striking example is the program's intensive investigation into Enron and other energy-related market abuses. Due to their complexity, the Enforcement program must devote significantly more resources to these investigations in order to analyze voluminous trading data and to examine the roles of diverse energy market participants and their practices. The investigative time lines for these matters has also decreased over time requiring adjustments to staff assignments than previously implemented in this program area.
- The Enforcement program continues to battle the pervasive fraudulent sale of illegal, off-exchange futures and options contracts to retail customers, including those involving precious metals and foreign currency. With respect to foreign currency, the Enforcement program expects that challenges to the Commission's jurisdictional authority will require additional resources to enforce against this area of fraud.
- The Enforcement program also focuses resources against other types of off-exchange fraud as well as fraud by registered and unregistered pool operators and trading advisors. These matters typically require immediate action using the Enforcement program's "quick strike" capability to freeze assets belonging to customers and preserve books and records. The Enforcement program

anticipates that it will need to devote additional resources to assessing the accuracy of CPO and commodity trading advisor risk, capitalization, and performance disclosures.

- Violative Internet solicitations continue to increase and, therefore, require additional resources to investigate and prosecute.
- The USA PATRIOT Act and anti-money laundering regulations have increased the responsibilities of registered firms by requiring new transaction reporting requirements and the establishment of anti-money laundering and customer identification and verification programs. The Enforcement program may need to take direct and/or cooperative enforcement action when firms fall short of these obligations.
- The dramatic increase in electronic trading poses additional challenges to the Enforcement program in terms of potential novel violations (or adaptations of traditional trade practice violations) and potential audit trail gaps. These challenges will require additional resources not only for investigation and prosecution but also for Enforcement staff training.

Responding to Violative Conduct. When an enforcement investigation indicates that violative conduct has occurred, the Commission either files an administrative or civil injunctive enforcement action against the alleged wrongdoers. In administrative actions, wrongdoers found to have violated the CEA or Commission regulations or orders can be prohibited from trading and, if registered, have their registrations suspended or revoked. Violators also can be ordered to cease and desist from further violations, to pay civil monetary penalties of up to \$120,000 per violation or triple their monetary gain, and to pay restitution to those persons harmed by the misconduct. In civil injunctive actions, defendants can be enjoined from further violations, their assets can be frozen, and their books and records can be impounded. Defendants also can be ordered to disgorge all illegally obtained funds, make full restitution to customers, and pay civil penalties.

As detailed above, violations prosecuted by the Enforcement program may arise from commodity futures or option trading on U.S. exchanges or from the sale of illegal futures or option contracts not traded on trading facilities designated or registered by the Commission. The Enforcement program addresses various types of violative conduct including conduct that threatens the economic functions of the markets. For example, one function of the futures markets is to provide an accurate reflection of cash or spot commodity prices based on legitimate supply and demand forces—in other words, to provide a price discovery mechanism. Therefore, the markets must remain free of fraud, manipulation, and abusive trade practices that undermine this price discovery function. The Enforcement program will investigate and bring enforcement actions against possible manipulation and illegal trade practices by market participants. Through these actions, the Commission can remove threats to the market by imposing trading prohibitions and registration revocations on abusive traders. These cases are often highly complex and labor intensive because they require staff to reconstruct transactions and analyze complex trading strategies, as is occurring, for example, in the Enron and other energy-related investigations. Other examples include the Enforcement program's recent investigations of a price spike in the Natural Gas market and potential leaks regarding BSE "Mad Cow" testing results affecting the cattle markets.

Protecting Market Users. The Enforcement program also works to protect market users and the public by promoting compliance with and deterring violations of the CEA and Commission regulations. The bulk of the work in this area in-

volves investigating and bringing enforcement actions in matters involving fraud and imposing sanctions against wrongdoers. These actions send a message to industry professionals about the kinds of conduct that will not be tolerated. These actions also seek to protect the funds of market participants, both large and small.

The Enforcement program pursues actions involving various types of fraudulent conduct. For example, it pursues fraud cases against registered and unregistered CPOs and CTAs who provide trading advice—often the small investor's first avenue into the markets. These cases frequently involve misappropriation from victims who have pre-existing business, social, religious, or ethnic ties to the defendants. CPOs and CTAs matters have also increasingly involved potential false or misleading risk, performance or capitalization disclosures.

The Commission also pursues actions involving false or misleading advertising. Over the past several years, there has been substantial false and deceptive advertising of commodity-related investment products, often by unregistered persons and entities through various forms of mass media, such as cable television, radio, and the Internet. The Enforcement program has worked aggressively to detect and stop such advertising by filing enforcement actions. Similarly, the Enforcement program pursues cases charging illegal futures and options, often in forex and precious metals. Such cases typically involve unregistered "boiler rooms" selling illegal futures contracts and options to the general public. Again, the most likely victims are individual retail investors.

Quick-Strike Capability. The Enforcement program uses its quick-strike capability effectively to prosecute those engaged in ongoing fraud where customer funds are at risk. In quick-strike cases, the Enforcement program prosecutes civil injunctive actions against wrongdoers as soon as possible after violative conduct is detected. The goal is to obtain injunctive relief rapidly, thereby preserving customer funds and preventing the destruction of records that may prove wrongdoing and/or identify customer funds. When possible, cases are brought to obtain injunctive relief within days of detecting the wrongdoing.

Supervision and Compliance Failures. The Enforcement program also investigates and prosecutes cases involving supervision and compliance failures by registrants handling customer business. Such violations can threaten the financial integrity of registered firms holding customer funds and can, in certain circumstances, threaten the financial integrity of clearing organizations. In addition, without adequate supervision and compliance systems in place, customers remain vulnerable to fraud, including misallocation of trades and unauthorized trading. Diligent supervision by registered firms also protects markets from abusive trading practices, including manipulation and wash sales.

Under the USA PATRIOT Act, the Enforcement program expects to have additional responsibilities for ensuring that registrants have proper supervision and record-keeping programs in place to fight money laundering. Cases alleging supervision and compliance failures can result in substantial remedial changes in the supervisory structures and systems of large FCMs. These cases have had a significant impact on the way particular firms are required to do business and are an important part of the responsibility of the Commission to ensure sound practices by registered firms.

Cooperative Enforcement Efforts. The Enforcement program works cooperatively with both domestic and foreign authorities to maximize its ability to detect, deter, and bring sanctions against wrongdoers involving U.S. markets, registrants, and customers. The benefits of cooperative enforcement include:

- Use of resources available from other authorities to support Commission enforcement actions;
- Coordination of the filing of actions with other authorities to further the impact of enforcement efforts; and
- Enhancement of the consistency and clarity of governmental responses to misconduct and avoidance of duplication of efforts by authorities.

On the domestic level, this includes sharing information with, and on occasion providing testimony or other assistance to, state regulators and other Federal agencies, such as the Department of Justice (DOJ), the FBI, the SEC, the FERC, and Federal banking regulators. The Commission may also file injunctive actions jointly with state authorities with concurrent jurisdiction. These cooperative efforts bolster the effectiveness of the Enforcement program by allowing it to investigate and litigate more efficiently.

Similarly, in the international realm, the Commission has entered into more than a dozen formal information-sharing arrangements and numerous other informal arrangements with foreign authorities. These arrangements permit information sharing and cooperative assistance among regulators. Such arrangements benefit all nations involved and greatly enhance the ability of the Enforcement program to investigate matters that involve, foreign entities and/or, individuals or transfers of tainted funds to foreign individuals. (See *Working Relationships* for a fuller discussion of cooperative enforcement efforts.)

Impact of Requested Level of Resources

The markets continue to grow in volume and complexity as increasingly sophisticated instruments are being employed across markets. An ever-larger segment of the population has money at risk in the futures markets, either directly or indirectly through pension funds or ownership of shares in publicly held companies that participate in the markets. Moreover, the markets continue to provide a price-basing function for transactions in interstate commerce. The growing globalization of futures markets presents new challenges for the Enforcement program and new demands on its resources. The ability of the Enforcement program to institute enforcement cases serves as a powerful deterrent, discouraging wrongdoers and engendering confidence in the markets.

The Enforcement program will utilize the FTEs requested for FY 2006 in targeting certain program areas, for example: 1) allegations of manipulation, trade practice violations, and false reporting; 2) supervision, reporting, and record-keeping by registrants as required under the USA PATRIOT Act and anti-money laundering regulations; 3) fraud and other illegal conduct committed by registered entities; 4) off-exchange fraud, involving illegal futures and options contracts by, among others, unregulated boiler rooms and bucket shops targeting the general public; and 5) unregistered CTA/CPO fraud, in general, and false risk, performance, and capitalization disclosures in particular. The requested FTEs will also enable the Enforcement program to: fully staff its Kansas City office; continue its commitment both to cooperative enforcement activities; and to provide its staff with training opportunities designed to increase their expertise and effectiveness.

Consequences of Not Receiving Requested Level of Resources

In recent years, the Enforcement program has been striving to process an increasing number of investigatory matters and to conduct those investigations in shorter time frames than historically allotted in order to be able to address a wide range of potential violations. Over each of the past two fiscal years, the program filed more actions than at any other time in Enforcement's history. One of the cornerstones of effective enforcement is the program's ability to pursue significant violations of all types, whether they result in large, complex market investigations and cases or discrete retail fraud matters. Adequate staffing levels give the Enforcement program the flexibility to address conduct that gives rise to complex investigations and litigation as well as conduct, which, though equally serious, may not require the same resources to address effectively.

A lower level of staffing will not permit Enforcement to meet established responsibilities. Without adequate staffing, the Enforcement program must be more selective in the matters it investigates, potentially leaving serious wrongdoing, like the ongoing energy-related manipulation and trade practice matters, unaddressed. In addition, investigations will take longer to complete, particularly when priority litigation needs draw resources away from investigations. Emergency enforcement actions to address ongoing fraud may be delayed or may draw staff from other pending matters, thereby interfering with the timely completion of complex investigations and cases. Domestic and international cooperative enforcement activities may be undermined, adversely affecting not only the mission of the Commission, but also that of its domestic and international counterparts. With insufficient staff, the Enforcement program's ability to target certain problem areas, such as retail fraud, will be limited. The Commission's Enforcement program also will be unable to maintain the training required of a nationwide enforcement program.

If the Enforcement program is unable to bring actions because of insufficient resources, other authorities may not be available to step in and fill the void. SROs can take action only against their own members, and their sanctions cannot affect conduct outside their jurisdiction or markets. In addition, other Federal regulators and state regulators have limited jurisdiction and expertise in handling futures-related misconduct. Finally, while criminal prosecutions by the DOJ are an important adjunct to effective enforcement of the CEA, the criminal justice system is not an adequate substitute for aggressive civil regulatory enforcement.

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Table 6: Enforcement Request

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Enforcement	\$27,923	139.00	\$29,565	139.00	\$1,642	0.00
TOTAL	\$27,923	139.00	\$29,565	139.00	\$1,642	0.00

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Table 7: Enforcement Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$5,532	27.54	\$7,176	33.74	\$1,644	6.20
Subtotal Goal One	\$5,532	27.54	\$7,176	33.74	\$1,644	6.20
GOAL TWO: Protect market users and the public.						
Outcomes						
2.1 Violations of Federal commodities laws are detected and prevented.	\$17,808	88.65	\$16,652	78.29	-\$1,156	-10.36
2.2 Commodities professionals meet high standards.	96	0.48	145	0.68	49	0.20
Subtotal Goal Two	\$17,904	89.13	\$16,797	78.97	-\$1,107	-10.16
GOAL THREE: Foster open, competitive, and financially sound markets.						
Outcomes						
3.1 Clearing organizations and firms holding customer funds have sound financial practices.	\$2,045	10.18	\$2,550	11.99	\$505	1.81
3.2 Commodity futures and option markets are effectively self-regulated.	32	0.16	64	0.30	32	0.14
3.3 Markets are free of trade practice abuses.	2,127	10.59	2,653	12.47	526	1.88
3.4 Regulatory environment responsive to evolving market conditions.	261	1.30	325	1.53	64	0.23
Subtotal Goal Three	\$4,465	22.23	\$5,592	26.29	\$1,127	4.06
TOTAL	\$27,901	138.90	\$29,565	139.00	\$1,664	0.10

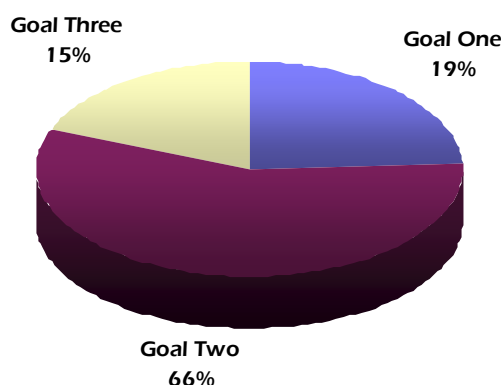


Figure 19: Enforcement FY 2006 Budget by Goal

Office of the Chief Economist

Total Budget:	\$ 1,828,000	9 FTEs
Total Change:	\$ 103,000	0 FTE

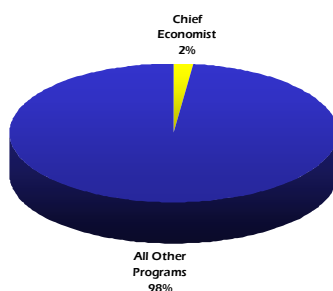


Figure 20: Chief Economist
Percentage of Total Budget Dollars

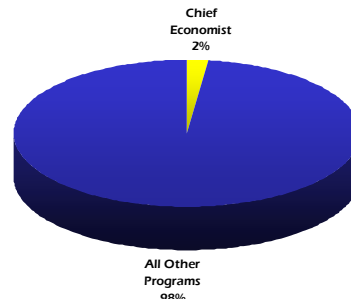


Figure 21: Chief Economist
Percentage of Total Budget FTEs

Justification of the FY 2006 President's Budget & Performance Estimate

As innovation in the futures and option markets continues, the ability of staff to conduct thorough market research is vital to achieving Commission goals. Innovations in technology and trading instruments and methods create significant challenges that require economic research in the form of:

- Participation in the development of flexible and effective regulatory responses to evolving market conditions;
- Review and analysis of new market structures and off-exchange derivative instruments over which the Commission may have jurisdictional authority;
- Frequent support to the Commission's Enforcement program in the form of economic and statistical analysis or expert testimony to promote compliance with and deter violations of commodity laws;
- Development of educational materials on futures and option trading for dissemination to producers, market users, and the general public; and
- Review and analysis of alternative derivative risk management models and risk-based capital requirement rules.

In FY 2006, the Office of the Chief Economist program level of nine FTEs would maintain staffing at the same level as the FY 2005 level.

Impact of Requested Level of Resources

The growth in the number of different types of markets that trade a wider array of derivatives products, particularly single-stock futures, requires analysis and research about new developments in derivatives trading. In FY 2006, staff of the Office of the Chief Economist will be required to monitor a large and diverse array of markets, including single-stock futures. The Commission anticipates that a large number of these contracts will be listed for trading, both on futures and securities exchanges.

With the requested level of resources, studies to enhance understanding of the markets will keep pace with the growth in new types of exchanges and the initiation of trading in new products. Moreover, at the requested level, the staff would be able to monitor most developments in derivatives trading and market innovations. In this regard, innovations in technology and derivative instruments and trading methods in futures markets create many challenging economic and regulatory issues. The performance of derivative markets has a potentially large impact on the stability of international and domestic financial markets. Market research and effective monitoring of these developments help ensure that the Commission has in place sound regulatory policies to reduce systemic risk in financial markets and protect the economic function of the markets without undermining innovation and the development of new approaches to risk management.

Consequence of Not Receiving Requested Level of Resources

If the Commission does not receive the resources requested for FY 2006 for the Office of the Chief Economist, the extent of its effort to conduct market research and analysis will not be commensurate with the growth in new types of exchanges, new trading execution methods in futures markets, and the initiation of trading in new products, such as single-stock futures. Moreover, staff efforts to monitor developments in derivatives trading and market innovation would be delayed. This would undermine the ability of the Commission to keep its regulatory policies in line with new developments in the industry, which could impede innovation, lead to systemic risk in financial markets, and adversely affect the economic function of the markets.

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Table 8: Office of the Chief Economist Request

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Chief Economist	\$1,725	9.00	\$1,828	9.00	\$103	0.00
TOTAL	\$1,725	9.00	\$1,828	9.00	\$103	0.00

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Table 9: Office of the Chief Economist Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$958	5.00	\$1,016	5.00	\$58	0.00
1.2 Markets that can be monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.	767	4.00	812	4.00	45	0.00
Subtotal Goal One	\$1,725	9.00	\$1,828	9.00	\$103	0.00
GOAL TWO: Protect market users and the public.						
None.						
GOAL THREE: Foster open, competitive, and financially sound markets.						
None						
TOTAL	\$1,725	9.00	\$1,828	9.00	\$103	0.00

Office of Proceedings

Total Budget:	\$ 2,677,000	14 FTEs
Total Change:	\$ 159,000	0 FTE

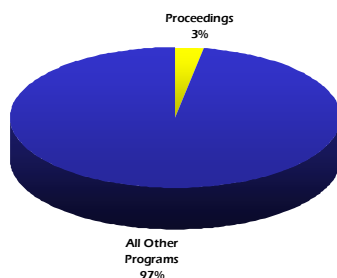


Figure 22: Proceedings Percentage of Total Budget Dollars

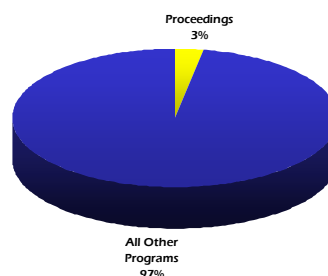


Figure 23: Proceedings Percentage of Total Budget FTEs

Justification of the FY 2006 President's Budget & Performance Estimate

The Office of Proceedings is responsible for providing an inexpensive, impartial, and expeditious forum for handling customer complaints against persons or firms registered under the CEA. In FY 2006, the Office of Proceedings program level of 14 FTEs would maintain staffing at the same level as the FY 2005 level.

The Complaints section of the Office of Proceedings receives and prepares customer claims for action by appropriate officials, dismissing those that are outside the jurisdiction of the Commission or are pending in another forum. The Hearings section includes judgment officers (JOs), who decide reparations complaints in voluntary and summary proceedings and administrative law judges (ALJs), who conduct formal proceedings.

The ALJs also decide administrative enforcement cases brought by the Commission against persons or firms responsible for violating the CEA or Commission regulations. The Office of Proceedings expects to carryover 20 administrative enforcement cases into FY 2006. This projection is based on estimates that 27 cases will be filed and 27 cases will be resolved.

The Office of Proceedings expects to carryover 64 reparations cases into FY 2006. This projection is based on estimates that 112 cases will be filed and 100 cases will be disposed of, leaving a balance of 87 reparations cases—23 cases in the Complaints section and 64 cases in the Hearings section.

In response to over 9,500 telephone inquiries each year, the Office of Proceedings also provides information about the complaints process and the number of complaints filed against specific firms. Many inquiries are from members of the public who are considering investing with these firms.

The Office of Proceedings maintains a case-tracking system that tracks the progress of each case from receipt of complaint through disposition, including any appeal to the Commission or Federal court. The case-tracking system not only assists with case management within the Commission, but it also enables the Of-

Office of Proceedings to provide current information on the status of cases in response to public inquiries.

The Office of Proceedings maintains the *Reparations Sanctions in Effect List* publication, a record of individuals and firms that have not paid reparations awards. This document is published annually and updated twice a month. The office also maintains the *Administrative Sanctions in Effect List* publication, a record of individuals and firms that have outstanding against them enforcement sanctions, such as trading prohibitions. This document is published annually and updated quarterly. These lists are made available to the public and are distributed to the exchanges, the NFA, the FIA, the National Association of Securities Dealers, and the SEC for use in their compliance efforts.

Consequence of Not Receiving Requested Level of Resources

The Office of Proceedings' ability to perform its activities in a timely fashion depends on the requested level. If the requested level is not received, the Office of Proceedings may experience time delays in the performance of its activities. For example, there may be time delays in: 1) reviewing and processing reparations complaints; 2) responding to requests for information from the public; 3) processing orders and decisions of the Commission in administrative enforcement and reparation cases; and 4) processing incoming documents and serving orders and decisions issued by ALJs and JOs in reparation cases.

FY 2006 President's Budget & Performance Estimate

Table 10: Proceedings Request by Subprogram

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Enforcement	\$719	4.00	\$765	4.00	\$46	0.00
Reparations	1,799	10.00	1,912	10.00	113	0.00
TOTAL	\$2,518	14.00	\$2,677	14.00	\$159	0.00

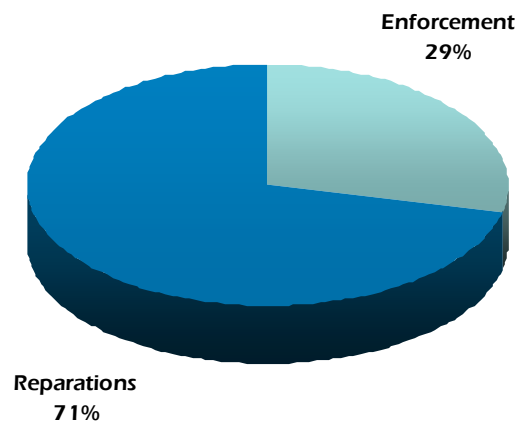


Figure 24: Proceedings FY 2006 Budget by Subprogram

FY 2006 President's Budget & Performance Estimate

Table 11: Proceedings Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
None						
GOAL TWO: Protect market users and the public.						
Outcomes						
2.1 Violations of Federal commodities laws are detected and prevented.	\$989	5.50	\$1,052	5.50	\$63	0.00
2.2 Require commodities professionals to meet high standards.	90	0.50	96	0.50	6	0.00
2.3 Customer complaints against persons or firms falling within the jurisdiction of the Commodity Exchange Act are handled effectively and expeditiously.	1,259	7.00	1,339	7.00	80	0.00
Subtotal Goal Two	\$2,338	13.00	\$2,487	13.00	\$149	0.00
GOAL THREE: Foster open, competitive, and financially sound markets.						
Outcomes						
3.3 Markets are free of trade practice abuses.	180	1.00	191	1.00	11	0.00
Subtotal Goal Three	\$180	1.00	\$191	1.00	\$11	0.00
TOTAL	\$2,518	14.00	\$2,678	14.00	\$160	0.00

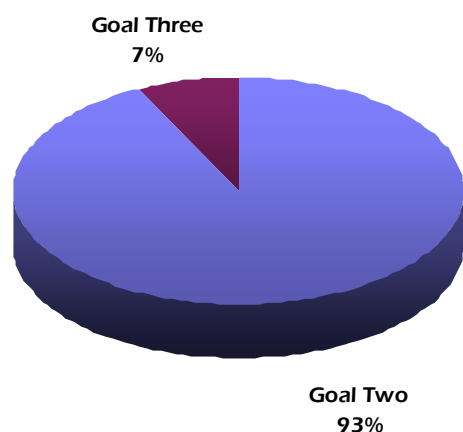


Figure 25: Proceedings FY 2006 Budget by Goal

Office of the General Counsel

Total Budget: \$ 6,583,000 31 FTEs
 Total Change: \$ 390,000 0 FTE

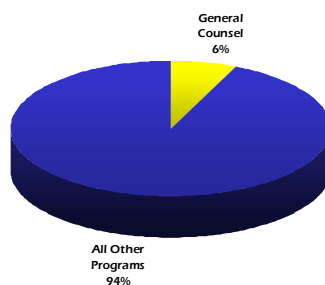


Figure 26: Percentage of Total Budget Dollars

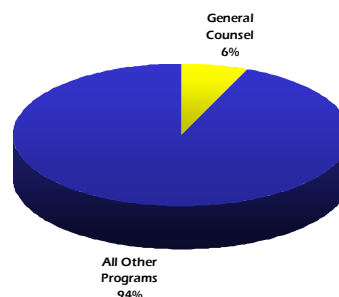


Figure 27: Percentage of Total Budget FTEs

Justification of the FY 2006 President's Budget & Performance Estimate

OGC provides legal services and support to the Commission and its programs. These services include: 1) engaging in defensive, appellate, and *amicus curiae* litigation; 2) assisting the Commission in the performance of its adjudicatory functions; 3) providing legal advice and support for Commission programs; 4) drafting regulations; 5) interpreting the CEA; 6) providing advice on legislative issues; and 7) providing exemptive, interpretive, and no-action letters and opinions to the public. In FY 2006, the OGC program level of 31 FTEs would maintain staffing at the same level as the FY 2005 level.

OGC is the legal advisor to the Commission, and a large portion of its workload is reactive in nature. The office:

- Reviews all substantive regulatory, legislative, and administrative matters presented to the Commission and advises it on the application and interpretation of the CEA and other pertinent administrative and legislative issues;
- Assists the Commission in performing its adjudicatory functions through its Opinions Program;
- Represents the Commission in appellate litigation and certain trial-level cases, including bankruptcy cases involving futures industry professionals;
- Provides legal support to Commission administrative programs, such as compliance with the Freedom of Information, Privacy, Government in the Sunshine, Regulatory Flexibility, Paperwork Reduction, Small Business Paperwork Reduction, and Federal Advisory Committee Acts;
- Monitors, reviews, and comments on proposed legislation affecting the Commission or the futures industry, prepares draft legislation as requested by members of Congress or their staff, and provides liaison with other Federal regulators as necessary on specific projects;
- Provides Commission support to the PWG and the President's Corporate Fraud Task Force;

- Counsels other Commission staff on legal aspects of various issues arising during the course of Commission business;
- Provides written interpretations of Commission statutory and regulatory authority to members of the public and, where appropriate, provides exemptive, interpretive, or no-action letters to regulatees and potential regulatees of the Commission;
- Advises the Commission on personnel, labor, contract, and employment law matters, including cases arising under Title VII of the Civil Rights Act of 1964 and Merit Protection Board cases arising under the Civil Service Reform Act of 1978; and
- Advises the Commission with respect to all matters related to the Commission's ethics standards and compliance with its Code of Conduct as well as with government wide ethics regulations promulgated by the Office of Government Ethics, including the requirement of annual ethics training for Commission employees.

OGC's activities, programs, and support contribute to all of the outcomes and functions of the Commission and have a direct and significant impact on the ability of the Commission to perform its mission.

Additional Responsibilities

In addition to the foregoing, as a result of external factors including: 1) the enactment of the CFMA, the Gramm-Leach-Bliley Act, and the USA PATRIOT Act; 2) controversial trading practices in the energy markets; and 3) the reorganization of certain responsibilities within the Commission, OGC has undertaken responsibilities in several additional areas as described below:

- *Gramm-Leach-Bliley Act*. OGC is involved in activity arising from Congress' passage of the Gramm-Leach-Bliley Act (GLBA), which facilitates the modernization of financial services. Among other things, the GLBA: 1) repeals Depression-era restrictions on affiliations among banks, securities firms, and insurance companies; 2) establishes parameters for conducting non-banking business within banks; and 3) reinforces the obligation of each financial institution to respect the privacy of its customers. As a Federal financial regulator under the GLBA, the Commission has adopted rules drafted by OGC that implement the privacy provisions of the GLBA and continues to coordinate with other Federal financial regulators in the uniform implementation of these provisions.
- *Ethics*. OGC is responsible for all matters relating to the Commission's ethics standards and compliance with its Code of Conduct and the Office of Government Ethics government wide ethics regulations. OGC also has assumed full responsibility for reviewing and certifying the confidential financial disclosure reports of approximately 367 Commission employees. Assumption of this function, previously the responsibility of the Office of Human Resources, has contributed to an increased workload for OGC, including intensive training of staff and allocation of significant staff time to the review of these reports. In addition to this additional responsibility, OGC continues to: 1) provide annual ethics training; 2) review and certify public financial disclosure reports; 3) counsel Commission personnel regarding ethics standards and programs; 4) advise departing and former Commission officials on post-employment conflict of interest responsibilities; 5) administer a system for periodic evaluation of the ethics program; 6) assist in tracking system implementation; and 7) provide support in coordinating with the Office of Gov-

ernment Ethics and ethics officials at other Federal financial regulatory agencies.

- *USA PATRIOT Act.* Title III of the USA PATRIOT Act, amending the Bank Secrecy Act, imposes a number of new anti-money laundering requirements on all financial institutions, including commodity pools as well as CPOs, CTAs, IBs, and FCMs. Although the U.S. Treasury Department has the lead authority under the Bank Secrecy Act to develop rules to implement those requirements, the Commission is actively participating in the rulemaking process and in issuing guidance to industry regarding these rules. OGC is working closely with Treasury, other Federal financial regulators, and interested parties to ensure that anti-money laundering rules do not place Commission registrants at a competitive disadvantage relative to other financial services providers. OGC also will be coordinating with market participants, the NFA, and other Commission programs on compliance and examination issues as the several new anti-money laundering rules continue to come into effect.
- *Federal Energy Regulatory Commission.* Recent concerns relating to the use of energy derivatives products in the markets for natural gas and electricity have resulted in increased regulatory and enforcement activity in this area by the Commission and the FERC, the Federal agency that regulates the Nation's wholesale power markets. The Commission's involvement derives from its role as regulatory overseer of the commodity futures and option markets and the increasing use of energy derivatives contracts by firms that trade in these markets. As a result of recent findings of trading abuse, false reporting, and attempted manipulation by some energy traders, the Commission is working with FERC to coordinate the agencies' law enforcement and regulatory efforts. In order for OGC to properly advise the Commission and carry out additional responsibilities in this area, it is necessary to maintain legal resources in OGC with appropriate expertise in the area of Federal energy regulation.
- *Antitrust Concerns.* In addition to its ongoing responsibility to advise the Commission regarding the antitrust and competitive implications of its actions, OGC's advisory role has expanded from the CFMA's enactment of the core principles relating to DCOs and the criteria for designation of boards of trade as contract markets. In particular, the CFMA requires the avoidance of "any material anticompetitive burden on trading" in contract markets. Also, the CFMA authorizes the Commission at the request of a DCO to issue an order concerning whether a rule or practice of the DCO is the "least anti-competitive means" of achieving the Act's objectives. Recent issues include competitive implications of incentive plans offered by emerging exchanges and international competition among exchanges. OGC is increasingly devoting resources to antitrust considerations in light of the additional responsibilities imposed by the CFMA.
- *Securities Law.* As the Commission continues to implement and administer its regulatory program for single-stock futures and other final rules related to security futures products, OGC continues to develop expertise with regard to the application of the securities laws and related rules to jointly regulated products and activities. This need has taken on greater relevance in light of the applicability of both Commission and SEC customer protection, record-keeping, reporting, and bankruptcy rules, and the Securities Investor Protection Act of 1970, to accounts holding security futures products, and the need for coordinated regulation of collective investment vehicles (including hedge funds) and the dually-registered managers who sponsor, operate, or advise

these vehicles. Coordinated agency enforcement under the CFMA continues, while the Commission works to address issues of U.S. investor access to foreign market products under the CFMA.

- *Administrative Responsibilities.* OGC has assumed full responsibility for the legal work required to discharge various administrative responsibilities of the Commission. Some of these responsibilities previously were undertaken by OED. These include analysis of appropriation law issues and responsibilities in the area of regulatory burden under statutes such as the Paperwork Reduction Act. Assumption of these functions has contributed to an increased workload for OGC. Responsibilities associated with the Paperwork Reduction Act, for example, necessitate significant staff time to identify when paperwork submissions must be filed or are about to expire, and to work with other Commission programs in ensuring that proper steps are taken on a timely basis to file or renew the submissions, where appropriate.

Commission Reauthorization

The current authorization for the Commission's appropriations extends through the end of FY 2005. The reauthorization process typically encompasses a comprehensive review of the Act, including its underlying purposes and objectives, and the regulatory structure implementing the Act. It also requires analysis of proposals to amend the Act advanced by industry participants as well as analysis of legislation proposed by members of Congress. The Commission's seventh reauthorization is likely to raise particularly complex issues since it will be the first reauthorization after the enactment of the CFMA and comes as the industry is undergoing rapid development in innovative trading systems, new business models, and novel products. In the event that the reauthorization process carries over into FY 2006, OGC will continue to monitor legislative activity and advise the Commission on the legal and programmatic implications of all legislative proposals. OGC also will assist the Commission in preparing legislative proposals it may submit to Congress.

Consequence of Not Receiving Requested Level of Resources

As a result of not receiving requested resource levels, OGC may experience time delays in performing its activities. For example, there may be time delays in:

- Performing its critical review function with respect to contract market designation applications and rule changes;
- Reviewing proposed enforcement actions;
- Assisting the Commission in the performance of its adjudicatory functions;
- Analyzing legislation and proposed legislation affecting the Commission or the futures industry;
- Carrying out its responsibilities to defend the Commission in appellate and other litigation; and
- Assisting the Commission in personnel, labor, contract, and employment law matters.

Moreover, a reduction in the requested level of resources would have an adverse impact on the ability of OGC to provide general legal advice and assistance to the Commission. OGC may also experience difficulty in fulfilling its advisory role to the Commission in connection with international cooperative efforts and in the provision of exemptive, interpretive, or no-action relief. Such an outcome would

have a direct and negative impact on the development of effective and timely responses to evolving market conditions.

The contribution of OGC to the goals and outcomes of the Commission is significant. The impact of not receiving the requested level of resources would be felt broadly, adversely affecting or completely impairing the Commission's ability to:

- Enforce the high standards for futures industry professionals mandated by Congress;
- Remain abreast of the rapid changes in the futures markets, resulting in regulatory impediments to private sector innovation;
- Enforce vigorously its consumer protection programs;
- Respond quickly to innovative off-exchange activities; and
- Deal effectively with market emergencies.

Many deadlines governing the litigation program are imposed by courts or other tribunals and are mandatory. The failure to adhere to such deadlines exposes the Commission to adverse decisions and potential sanctions, including monetary sanctions by courts or other tribunals. Other specific effects of a reduced level of resources in OGC could include a developing backlog of Commission adjudicatory cases; a curtailment of the *amicus curiae* program; a reduction in assistance to (and global coordination with) foreign governments as well as in cooperative efforts between the Commission and other federal and state regulators; and time delays in performing advisory and legal review functions in all areas.

FY 2006 President's Budget & Performance Estimate

Table 12: General Counsel Request

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
General Counsel	\$6,193	31.00	\$6,583	31.00	\$390	0.00
TOTAL	\$6,193	31.00	\$6,583	31.00	\$390	0.00

FY 2006 President's Budget & Performance Estimate

Table 13: General Counsel Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$1223	6.12	\$1,300	6.12	\$77	0.00
1.2 Markets that can be monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.	84	0.42	89	0.42	5	0.00
Subtotal Goal One	\$1,307	6.54	\$1,389	6.64	\$82	0.00
GOAL TWO: Protect market users and the public.						
Outcomes						
2.1 Violations of Federal commodities laws are detected and prevented.	\$1,962	9.82	\$2,085	9.82	\$123	0.00
2.2 Commodities professionals meet high standards.	390	1.95	414	1.95	24	0.00
2.3 Customer complaints against persons or firms falling within the jurisdiction of the Commodity Exchange Act are handled effectively and expeditiously.	965	4.83	1,026	4.83	61	0.00
Subtotal Goal Two	\$3,317	16.60	\$3,525	16.60	\$208	0.00
GOAL THREE: Foster open, competitive, and financially sound markets.						
Outcomes						
3.1 Clearing organizations and firms holding customer funds have sound financial practices.	\$397	1.98	\$420	1.98	\$23	0.00
3.2 Commodity futures and option markets are effectively self-regulated.	168	0.84	178	0.84	10	0.00
3.3 Markets are free of trade practice abuses.	382	1.91	406	1.91	24	0.00
3.4 Regulatory environment responsive to evolving market conditions.	625	1.13	665	1.13	40	0.00
Subtotal Goal Three	\$1,572	7.86	\$1,669	7.86	\$97	0.00
TOTAL	\$6,196	31.00	\$6,583	31.00	\$387	0.00

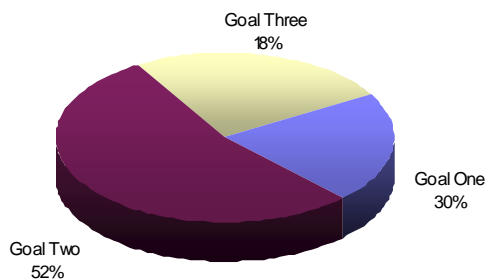


Figure 28: General Counsel FY 2006 Budget by Goal

Executive Direction & Support

Total Budget: \$27,911,000 137 FTEs
Total Change: \$ 1,631,000 0 FTE

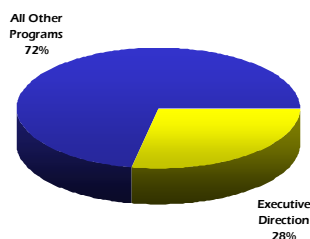


Figure 29: Percentage of Total Budget Dollars

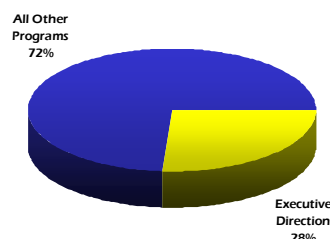


Figure 30: Percentage of Total Budget FTEs

Justification of the FY 2006 President's Budget & Performance Estimate

Agency Direction. The Commission develops and implements agency policy in furtherance of the purposes of the CEA. This policy is designed to foster the financial integrity and economic utility of commodity futures and option markets for hedging and price discovery, to conduct market and financial surveillance, and to protect the public and market participants against manipulation, fraud, and other abuses. Agency Direction is administered by the Chairman and Commissioners and includes the following offices of the Chairman: 1) External Affairs; 2) the Secretariat; 3) the Inspector General; and 4) International Affairs.

The Commission continues to implement the CFMA. The legislation, signed by President Clinton in December 2000: 1) repealed the ban on single-stock futures and implemented a regulatory framework for these instruments based on the agreement between the Commission and SEC; 2) enacted the principal provisions of the Commission's new regulatory framework; 3) brought legal certainty to bilateral and multilateral trading in over-the-counter financial markets; 4) confirmed the Commission's jurisdiction over certain aspects of the retail market in foreign exchange trading; and 5) gave the Commission authority to regulate clearing organizations. Implementation, which will continue in FY 2005 and FY 2006, is summarized briefly in the Progress Toward Outcomes section of this document on page 11.

In FY 2006, the Agency Direction program level of 42 FTEs would maintain staffing at the same level as the FY 2005 level.

Administrative Management and Support. Administrative Management and Support is provided by OED, which is responsible for policy development and implementation of the management and administrative functions of the Commission. OED staff:

Formulate budget and resource authorization strategies;

- Supervise the allocation and utilization of agency resources;
- Promote management controls and financial integrity;
- Manage administrative support offices;

- Manage the Commission's technical and information infrastructure;
- Manage human capital resource strategies;
- Oversee the development and implementation of the Commission's automated information systems; and
- Oversee the library services of the Commission.

In addition, the staffs of OED and subordinate offices oversee Commission-wide compliance with Federal requirements enacted by Congress and imposed by the Office of Management and Budget (OMB), the U.S. Treasury Department, the General Accounting Office (GAO), and the Office of Personnel Management (OPM). The administrative support offices include the offices of Financial Management (OFM), OIRM, Human Resources (OHR), OMO, and the Commission Library.

In FY 2006, the Administrative Management and Support program level of 95 FTEs would maintain staffing at the same level as the FY 2005 level.

The Budget and Planning Section of the Office of Financial Management seeks to improve Annual and Strategic Planning at the Commission, specifically developing a planning system that simultaneously serves the statutory requirements, including the Government Performance and Results Act of 1993 (GPRA), Federal Information Security Management Act (FISMA), Federal Managers' Financial Integrity Act (FMFIA), and Tax Accountability Act; and administration requirements – such as the President's Management Agenda (PMA) (which emphasizes strategic management of human capital, competitive sourcing, improved financial performance, expanded electronic government, and budget and performance integration) and provides a more meaningful planning and performance management tool for Commission managers.

The Accounting and Finance Section of OFM seeks to provide technical and project management support for CFTC's core financial management system, asset management system, eTravel system, Internet and Intranet Web content, and financial statement and program management reporting. Technical and project management support includes evaluating and implementing systems and business processes to ensure compliance with CFTC, GAO, GSA, OMB/Joint Financial Management Improvement Program (JFMIP), and Treasury requirements. This position would also have overall responsibility for planning and managing OFM's financial support team and its initiatives.

In the past decade the burden of statutory and regulatory- mandated reporting has increased substantially. In order for the Commission to consistently meet these reporting requirements and more importantly ensure that the financial, budgetary and procurement data we are reporting reflects well on the Commission, the OFM staff needs greater capacity to plan for and coordinate these reporting requirements. Currently, OFM managers are stretched too thin – they do planning, they do the actual work, they coordinate the reporting of the work and spend an enormous amount of time on an annual basis updating and conforming to the ever changing form and content requirements mandated by Congress, OMB and GSA. This position is intended to reduce the amount of time spent by OFM and program managers coordinating with each other on reporting, thereby freeing them to focus on the substance of what is being reported.

The Commission seeks to tie employee performance compensation to agency strategic goals and performance measures, by developing and implementing a modern system of pay-for-performance in order to effectively implement the pay parity authority under the Farm Security and Rural Investment Act of 2002. This

system is an essential step in achieving both the modernization of civil service practices called for in the President's Management Agenda and the goal of recruiting and retaining mission-critical employees who have a focus on citizen-centered results.

The Commission must utilize its authority to develop and implement a more flexible system of classifying positions in place of the current 60-year-old system. A new system can realize the potential of e-Government, through a flexible automated system of pay banding based on automated required program skills merged with employee competency inventories, and career development. Pay banding will further agency strategic needs by aiding in workforce and succession planning, recruiting and retaining highly qualified staff and in sustaining performance.

Consequences of Not Receiving Requested Level of Resources

Agency Direction. Without the requested level of resources, the Offices of the Commissioners and Chairman would suffer a diminution in the administrative and regulatory responsiveness of the Commission. For example, public outreach, responsiveness to Congress, other government agencies, international organizations and foreign governments, the futures industry, and other public inquiries may be slower, or administrative and technical review of Commission memoranda, correspondence, or official actions, such as responding to FOIA requests, may take longer. In addition, not meeting statutory deadlines associated with FOIA and other legislative mandates would cause additional workload on the appeals and litigation process for the attorneys in the General Counsel's office.

Administrative Management & Support. Without the requested level of resources, the Administrative Management & Support subprogram would impair its ability to manage the: 1) increased complexity associated with novel programs under pay parity and directives related to the President's Management Agenda; 2) accelerated modernization of the Commission's human capital programs, such as pay for performance and pay banding; 3) workforce/succession planning needed to address the anticipated retirements of 20 percent of the CFTC workforce in April 2006; 4) the increased regulatory and administrative responsibilities imposed by GAO, GSA, OMB/JFMIP, the Department of the Treasury and legislative mandates such as GPRA, GISRA, FMFIA, and the Tax Accountability Act.

FY 2006 President's Budget & Performance Estimate

Table 14: Executive Direction & Support Request by Subprogram

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
Agency Direction	\$8,854	42.00	\$9,386	42.00	\$532	0.00
Admin. Mgmt. & Supp.	17,426	95.00	18,525	95.00	1,099	0.00
TOTAL	\$26,280	137.00	\$27,911	137.00	\$1,631	0.00

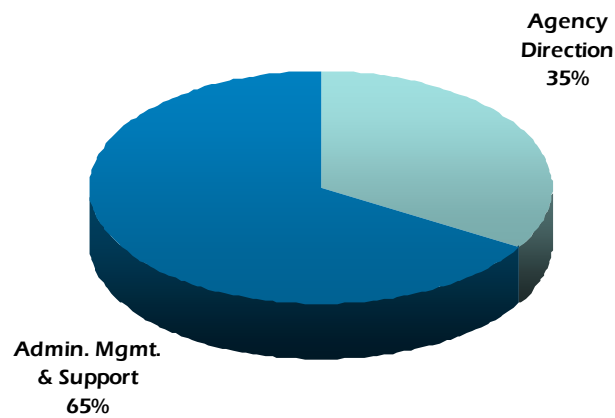


Figure 31: Executive Direction & Support FY 2006 Budget by Subprogram

FY 2006 President's Budget & Performance Report

Table 15: Executive Direction & Support Request by Goal

	FY 2005		FY 2006		Change	
	\$ (000)	FTE	\$ (000)	FTE	\$ (000)	FTE
GOAL ONE: Protect the economic functions of the commodity futures and option markets.						
Outcomes						
1.1 Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	\$605	3.30	\$605	3.10	\$0	-0.20
1.2 Oversee markets which can be used effectively by producers, processors, financial institutions, and other firms for the purposes of price discovery and risk shifting.	1,871	10.20	984	5.05	-887	-5.15
Subtotal Goal One	\$2,476	13.50	\$1,589	8.15	-\$887	-5.35
GOAL TWO: Protect market users and the public.						
Outcome						
2.3 Customer complaints against persons or firms falling within the jurisdiction of the Commodity Exchange Act are handled effectively and expeditiously.	220	1.20	302	1.55	\$82	0.35
Subtotal Goal Two	\$220	1.20	\$302	1.55	\$82	0.35
GOAL THREE: Foster open, competitive, and financially sound markets.						
Outcomes						
3.1 Clearing organizations and firms holding customer funds have sound financial practices.	\$633	3.45	\$127	0.65	-\$506	-2.80
3.2 Commodity futures and option markets are effectively self-regulated.	1,264	6.00	1,438	6.50	174	0.50
Subtotal Goal Three	\$1,897	9.45	\$1,565	7.15	\$332	-2.30
Unallocated						
Unallocated & Prorated	21,686	112.85	23,264	114.05	1,578	1.20
Subtotal Unallocated	\$21,686	112.85	\$23,264	114.05	\$1,578	1.20
TOTAL	\$26,279	137.00	\$26,720	130.90	\$441	-6.10

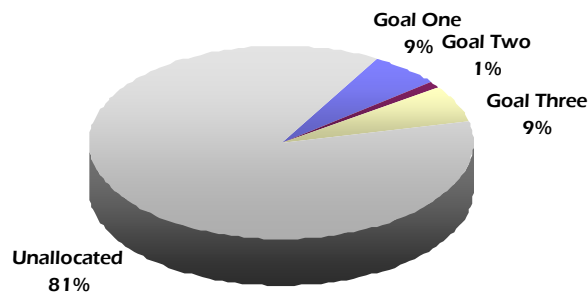


Figure 32: Executive Direction & Support FY 2006 Budget by Goal

Implementing the President's Management Agenda

The Commission continues to make progress in meeting the five goals of the President's Management Agenda as discussed below:

Strategic Management of Human Capital

In line with the President's Management Agenda, OHR continues to focus on strategic management of human capital as its priority goal. Progress to date retains a self rating of yellow, since specific programs are in place to address, and are gaining strength to meet, each standard for success under that goal on the Executive Branch Management Scorecard. Specific ongoing activities relative to each standard are as follows:

- Strategy aligned with mission, goals, and organizational objectives. The Commission's human capital strategy has focused on initial implementation of its authority, provided by the Farm Security and Rural Investment Act of 2002, to provide pay and benefits parity with other Federal financial regulators. The Commission has approved and OHR has taken the initial formal steps to implement an alternative compensation system that is specifically designed to support many of the other criteria under this goal, such as recruiting and retaining mission-critical employees with up-to-date skills who can support a more responsive organizational structure.
- Citizen-centered organizational structure. Since the passage of the CFMA in December 2000, OHR has supported the Commission's plan to convert from a front-line regulator to an oversight body. This planning has culminated in several stages of Commission restructuring into a flatter organization with more efficient lines of authority and greater outward focus on industry participants. In its new form, the Commission will continue to review and change its business practices so as to fully realize the potential offered by the CFMA to center its activities on the citizenry and its mission.
- Sustains performance, utilizes flexibilities, and plans succession. OHR actions responsive to each element include: 1) enlarged executive and other individual training plans and programs to enhance the depth of management talent and employee skills, including information technology; 2) use of system flexibilities, including recruitment bonuses, retention allowances, a completed, pending student loan repayment plan, and technology and tools that range from an online orientation emphasizing electronic references for new employees such as health plan options to phased implementation of new staffing flexibilities, including category ranking; 3) developing plans to follow up on the Commission's restructuring with a systematic review of agency recruitment and job classification practices.
- Meet mission-critical skill needs. Agency restructuring under the CFMA continues to reorganize Commission programs around broader functional roles, rather than more limiting subject matter areas. For example, the programs continue to merge units that had been responsible for narrow types of cases into flatter units that are each capable of responding to the full range of cases or requests. This continues to improve both the responsiveness of programs and offices and the ability to cross-train staff so that the greatest number may develop the skill sets currently in demand.
- Reward performance. The Commission implemented a revised performance appraisal system on July 1, 2002. It includes features designed to improve the communication process, assure an initial and continuing communication of yearly goals, provide for objective review and assessment geared toward

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results, and reward employee contributions promptly. The Commission will review the system's first full year of operation to identify further ways to increase the link of pay to performance.

- *Workforce emphasizes e-government and competition.* The Commission has continued to aid its employees to develop modern workforce skills by offering a quarterly curriculum of in-house training covering line program issues and information technology as well as prototyping of industry e-learning seminars and linking our employees to OPM's e-Learning center. The Commission has demonstrated its own commitment by implementing the government wide e-security, e-training, and associated Web-based payroll software in anticipation of e-payroll. Competitive bidding resulted in award of contracts to support development of Commission's evolving compensation programs now being implemented, including pay for performance, and special temporary needs for support staff. On-site procurement training enhanced Commission-wide awareness and use of competitive sourcing.

OHR continues to base its planning on the expectation that actions under each criterion above will reinforce the activities relative to all the other criteria, continuing agency progress toward full realization of the overall standards for success represented by a green light rating.

Expanding Electronic Government

Expanding electronic government to serve citizens and help the Commission meet the demand for online government is extremely challenging. However, the Commission has completed its first step in the government-to-business initiative for online rulemaking. A citizen can now use the one-stop service delivery integrated through *Firstgov.gov* to access the Commission's docket information. As this initiative develops further within the top 10 rulemaking agencies, the Commission will stay abreast of the requirements to migrate to a unified cross-agency online rulemaking docket system.

During FY 2003, the Commission also focused on upgrading its internal processes to more efficiently and effectively support the exchanges' electronic submission of financial data. Working with the major exchanges, such as NYMEX, NYBOT, and CBOT, the Commission now receives and processes weekly, rather than monthly, data files using file transport protocols rather than data tapes. Migrating to this technical approach of receiving information eases the reporting burden on the exchanges and provides a more efficient and timely manner for the Commission to receive and manage exchange data submissions.

Competitive Sourcing

The Commission continues incorporating the elements of performance-based service contracting in its service contract.

Improved Financial Performance

OFM continues to work toward improving its financial performance through increasing the efficiency of financial reporting, enhancing financial systems to improve functionality and strengthen regulatory compliance, and improving the technical skills of the staff through on-the-job cross-training as well as participation in seminars, conferences, and other formal training events. Initiatives for improving the Commission's financial performance to meet the core criteria for successful financial management standards include the following:

- *Financial management systems meet Federal financial management systems requirements and applicable Federal accounting and transaction standards.* As a result of the passage of the Accountability of Tax Dollars Act of 2002 and the E-Government Act of 2002, OFM will complete an in-depth

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analysis of the Commission's financial management system to determine if: 1) all regulatory, management, program, and operating needs are met; 2) the system continues to be the most cost-effective and efficient system available in comparison to other OMB/JFMIP-certified financial systems; and 3) the Commission needs to pursue the acquisition and implementation of a new system that will better meet its needs. In FY 2005, OFM will complete the analysis and develop a plan for enhancing its current financial system or acquiring and implementing a new system. Enhancements to the current system or implementation of a new system will begin in FY 2005 with plans to become operational in FY 2006.

In addition to reviewing the Commission's core financial system, an assessment of the its asset management system will be completed. The Commission lacks a comprehensive asset management program, a centralized automated software system, and overall support for financial management reporting and systems compliance. The Commission's FY 2002 Federal Managers' Financial Integrity Act Report identified this system as a material weakness and provided a remediation plan. In FY 2004, OFM completed the establishment of Commission policy on depreciation and capitalization and revalued its assets on the agency's financial statements. In FY 2005, OFM will lead a team in developing an integrated, agency-wide solution for implementing an asset management system to become operational by FY 2006.

The E-Government Act has resulted in the passage of an eTravel Service (eTS) initiative by the General Services Administration (GSA) to improve financial performance of agency travel services. In FY 2004, Commission completed and submitted its migration plans and schedules for implementing eTS through an interagency agreement with the Department of Interior's National Business Center (DOI-NBC). In FY 2005, the Commission will work with the DOI-NBC to begin migration to eTS with planned implementation no later than FY 2006.

- *Accurate and timely financial information.* In FY 2004, OFM submit fully complied with the requirements of the Accountability Act, including the completion of an independent audit of the agency's financial statements and publishing its first Performance and Accountability Report. The audit results will provide the agency with a roadmap for improving the accuracy of its financial information and reporting for FY 2005, including accurate and timely submission of information on a quarterly basis.
- *Integrated financial and performance management systems supporting day-to-day operations.* In FY 2004, OFM completed an assessment of its current methods for producing financial and performance data from its systems. As a result, enhancements to the core financial system were made to will provide better integration of cost and performance data. In FY 2005, OFM will continue its effort to improve the integration of financial and performance data to support better performance measurement and decision-making regarding the Commission's resources.
- *Unqualified and timely audit opinions.* The Accountability of Tax Dollars Act of 2002 required the Commission to comply with reporting requirements of the Chief Financial Officers Act of 1990 for FY 2004. Reporting requirements include submitting audited financial statements for fiscal year-end. In FY 2005, the Commission received the results of its first audited financial statements and OFM developed plans for correcting reported deficiencies.

Budget & Performance Integration

The Commission continues to make steady progress toward achieving the accelerated financial reporting requirements of the President's Management Agenda. During the FY 2004 reporting cycle the Commission issued its first Performance

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and Accountability Report by the mid-November due date. In FY 2005, we are conforming to the accelerated reporting requirement.

In addition we continue to make progress with respect to each of the standards for success associated with the President's goal of budget and performance integration as outlined below:

- *Creation, implementation, and monitoring of an integrated performance plan/budget.* The FY 2006 OMB budget request and the Annual Performance Plan are integrated—with the budget showing the request broken out by object class, by program, and by strategic goal and planned outcome. The submission has been renamed, the *FY 2006 OMB Budget & Performance Estimate*.

To further demonstrate the Commission's progress, the Budget & Planning and Accounting teams of OFM have begun working to restructure the financial management system to align the monitoring of spending with that of budgeting or planning for spending. This meant a complete overhaul of the Management Accounting Structure Code (MASC) system to better align it with the goals, outcomes, and business processes of the new strategic performance planning and measurement structure.

- *Performance plan/budget sets forth outcome goals, output targets, and requested resources in context of past results.* As mentioned previously, a new strategic planning and measurement structure guided the Commission's latest development of the integrated performance plan and budget. The modifications to the structure were based on input from the Chairman and senior executive staff and evaluations of past performance conducted quarterly by program managers. In addition, the GAO critiqued the Commission's strategic planning structure, providing valuable suggestions regarding how to improve its effectiveness. This year's efforts and these internal evaluations and past critiques have led to a more streamlined set of business processes and performance indicators of success, measures of outcome, and annual performance targets.
- *Budget accounts, staff, and programs/activities are aligned to achieve program targets.* The work of the Budget & Planning and Accounting teams to restructure budget accounts and the MASC system has enabled a better understanding by program staff of how their activities help the Commission reach its goals, outcomes, and performance targets. As a result, monitoring of resource expenditures—monetary and human—will become more successfully aligned as originally envisioned.
- *Full cost of outputs and programs is integrated with performance.* The Commission's fully integrated budget and performance estimate contain a cross-cutting analysis that demonstrates how the full cost of each budget request is fully integrated with planned performance. That is, the program-based and object class-based analyses of the request are augmented by a programmatic distribution of resources by each of the Commission's strategic goals. Conversely, the goal-based analysis of request's planned performance also disaggregates resources by program. This analysis was developed both to demonstrate that full costs were integrated with performance *and* to engender greater understanding among the public, the Congress, the Administration, market users, and the many other interested persons and entities regarding how resources contribute to the accomplishment of the Commission's mission.
- *Agency documents program effectiveness, analyzes policies' impact on outcomes, and demonstrates how results inform budget decisions.* With the work of the senior staff to revamp the strategic performance planning and measurement system as well as the efforts of the Budget & Planning and Ac-

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counting teams of OFM to align planning and monitoring of resource expenditure, the Commission will have the foundation in place to begin documenting program effectiveness, analyzing the impact of policy decisions on outcomes, and demonstrating how performance results affect budget decisions. Since these efforts have just begun in FY 2005, achieving this standard for success, however, can only be realized in the future—hopefully by the end of the FY 2006 budget cycle.

The Commission rates its progress in this area as a “yellow,” meaning it has achieved some, but not all, of the core criteria outlined in the Executive Branch Management Scorecard.

APPENDIX

The Commissioners

Sharon Brown-Hruska, Acting Chairman

Sharon Brown-Hruska was designated by President Bush as Acting Chairman at the Commodity Futures Trading Commission (CFTC) on July 26, 2004. She was first nominated to the Commission by President Bush on April 9, 2002, confirmed by the Senate on August 2, 2002, and sworn in on August 7, 2002. She was subsequently nominated by President Bush to a second term as a Commissioner, and confirmed by the Senate on November 21, 2004, to a term expiring April 13, 2009.

In her capacity as Acting Chairman, Brown-Hruska serves as a member of the President's Working Group on Financial Markets along with the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve, and the Chairman of the Securities and Exchange Commission. Dr. Brown-Hruska is also the Chairman of the CFTC's Technology Advisory Committee.

Energy. In March 2003, then CFTC Chairman James Newsome announced that Dr. Brown-Hruska would be evaluating legislation, issues and economic developments of relevance to our Nation's energy markets, in addition to her other duties as a Commissioner. She has spoken on energy issues to many forums and organizations, including the Energy Bar Association, Edison Electric Institute, and the World Forum on Energy Regulation. She has recently published articles in the *Energy Daily* on energy derivatives and the *Futures and Derivatives Law Report* on market manipulation in the energy markets. For her work in this area, she was awarded the Key Women in Energy's Global Leadership Award, announced at the March 31, 2004, National Energy Marketers Association Conference in Washington, D.C.

Financial Literacy and Education. Dr. Brown-Hruska serves as the CFTC's representative on the Financial Literacy and Education Commission, chaired by Treasury Secretary John Snow. Subsequently, she was named Chairman of the Subcommittee on Web site Development, which is made up of representatives from various agencies within the Federal government. In September 2004, a Web site that serves as a clearinghouse for information on financial literacy was successfully launched.

Financial Markets. Dr. Brown-Hruska holds a Ph.D. in economics (1994) from Virginia Tech in Blacksburg, Virginia. Prior to coming to the CFTC, Dr. Brown-Hruska was an Assistant Professor of Finance at George Mason University's School of Management (1998 – 2002) and the A.B. Freeman School of Business at Tulane University (1995-1998). Courses taught by Professor Brown-Hruska included Risk Management and Financial Innovation, International Finance, Venture Capital, Investments, and Financial Markets. Dr. Brown-Hruska has authored numerous scholarly and applied papers based on her research in the areas of derivatives and market microstructure, including, "A Penny for Your Trade" in *Barron's* (2001); "Financial Markets as Information Monopolies?" in *Regulation* (2000), and "Fragmentation and Complementarity: The Case of EFPs" in the *Journal of Futures Markets* (2002).

A native of Winchester, Virginia, she lives with her husband Donald Hruska and their six-year-old son, Jacob, in Burke, Virginia.

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Walt L. Lukken, Commissioner

Walt L. Lukken was sworn in on August 7, 2002 as a Commissioner of the CFTC. He was nominated by President George W. Bush on April 16, 2002, and confirmed by the Senate on August 2, 2002, to a term expiring April 13, 2005.

Mr. Lukken joins the Commission after having served four years on the professional staff of the U.S. Senate Agriculture Committee under Ranking Member Richard Lugar. While working for the committee, Mr. Lukken specialized in futures and derivatives markets, agricultural banking, and agricultural tax issues. Before joining the committee, Mr. Lukken worked for five years in the personal office of Senator Lugar as a legislative assistant specializing in finance and tax matters.

A native of Richmond, Indiana, Mr. Lukken received his B.S. degree with honors from the Kelley School of Business at Indiana University, and his Juris Doctor degree from Lewis and Clark Law School in Portland, Oregon. Mr. Lukken is a member of the Illinois Bar.

Frederick W. Hatfield, Commissioner

Fred Hatfield was confirmed by the U.S. Senate on November 21, 2004, as a Commissioner of the Commodity Futures Trading Commission. He was sworn in on December 6, 2004, to a term expiring April 13, 2008.

Prior to joining the CFTC, Mr. Hatfield was Chief of Staff to Senator John Breaux (D-LA), Assistant Minority Whip. Mr. Hatfield also served as Chief of Staff to House Majority Whip, Tony Coelho (D-CA).

In 1998, Mr. Hatfield served as Deputy Commissioner General of the U.S. Pavilion at the World's Fair in Lisbon, Portugal.

Mr. Hatfield is a native of California and graduated Summa Cum Laude from California State University, Fresno.

Michael V. Dunn, Commissioner

Michael V. Dunn was sworn in as a Commissioner of the Commodity Futures Trading Commission (CFTC) on December 6, 2004, to a term expiring June 19, 2006. Mr. Dunn was nominated by President Bush on November 16, 2004, and confirmed by the U.S. Senate on November 21, 2004.

Mr. Dunn came to the Commission from the Office of Policy and Analysis at the Farm Credit Administration (FCA) where he was the Director. Prior to this position, in January 2001 he served briefly as a member of the FCA Board.

Prior to joining FCA, Mr. Dunn was the Under Secretary of Agriculture for Marketing and Regulatory Programs at the U.S. Department of Agriculture (USDA). He also served as the Acting Under Secretary for Rural Economic Community Development and as Administrator of the Farmers Home Administration (FmHA) at USDA.

Mr. Dunn has had a long involvement in agricultural credit dating back to the late 1970s, when he was the Midwest Area Director for the FmHA. He has been a loan officer and vice president of the Farm Credit Banks of Omaha and has served as a member of the Professional Staff of the Senate Agricultural Committee, specializing in agricultural credit. At the USDA, Mr. Dunn also served as a member of the Commodity Credit Corporation and Rural Telephone Bank Board. He is a

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past member of the Iowa Development Commission and has served as the Chairman of the State of Iowa's City Development Board.

A native of Keokuk, Iowa, and a current resident of Harpers Ferry, West Virginia, Mr. Dunn received his B.A. and M.A. degrees from the University of New Mexico.

Commodity Futures Trading Commission

Growth in Volume of Futures & Option Contracts Traded & FTEs

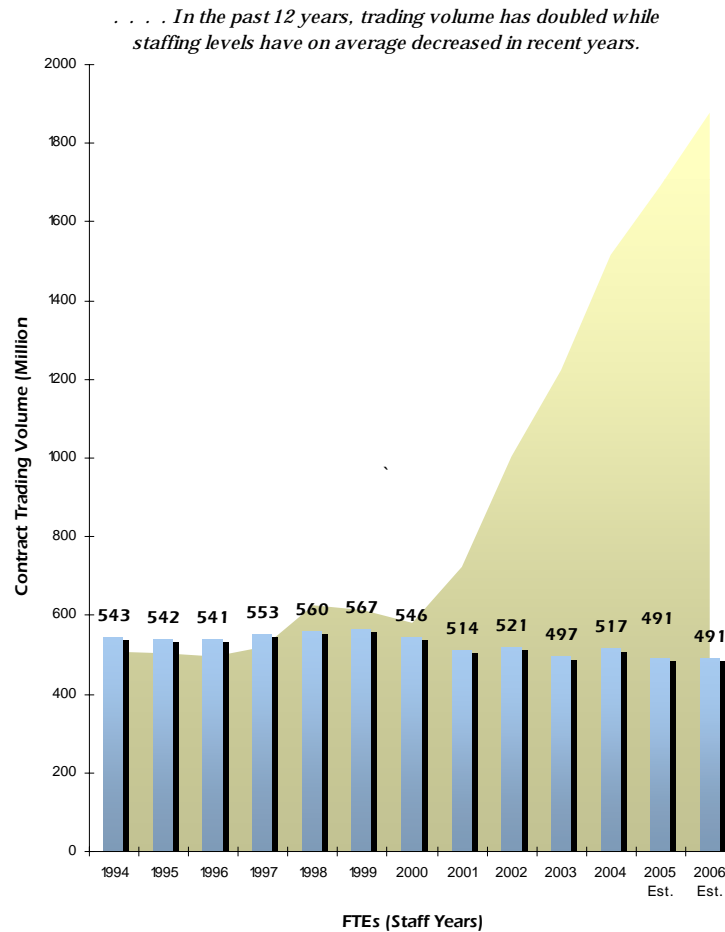


Figure 33: Growth of Volume of Contracts Traded and FTEs

Commodity Futures Trading Commission

Actively Traded Futures & Option Contracts

The number of actively traded contracts traded on U.S. exchanges has almost quadrupled in the last decade, 1993-2004.

The number is expected to grow to over 600 contracts by FY 2006.

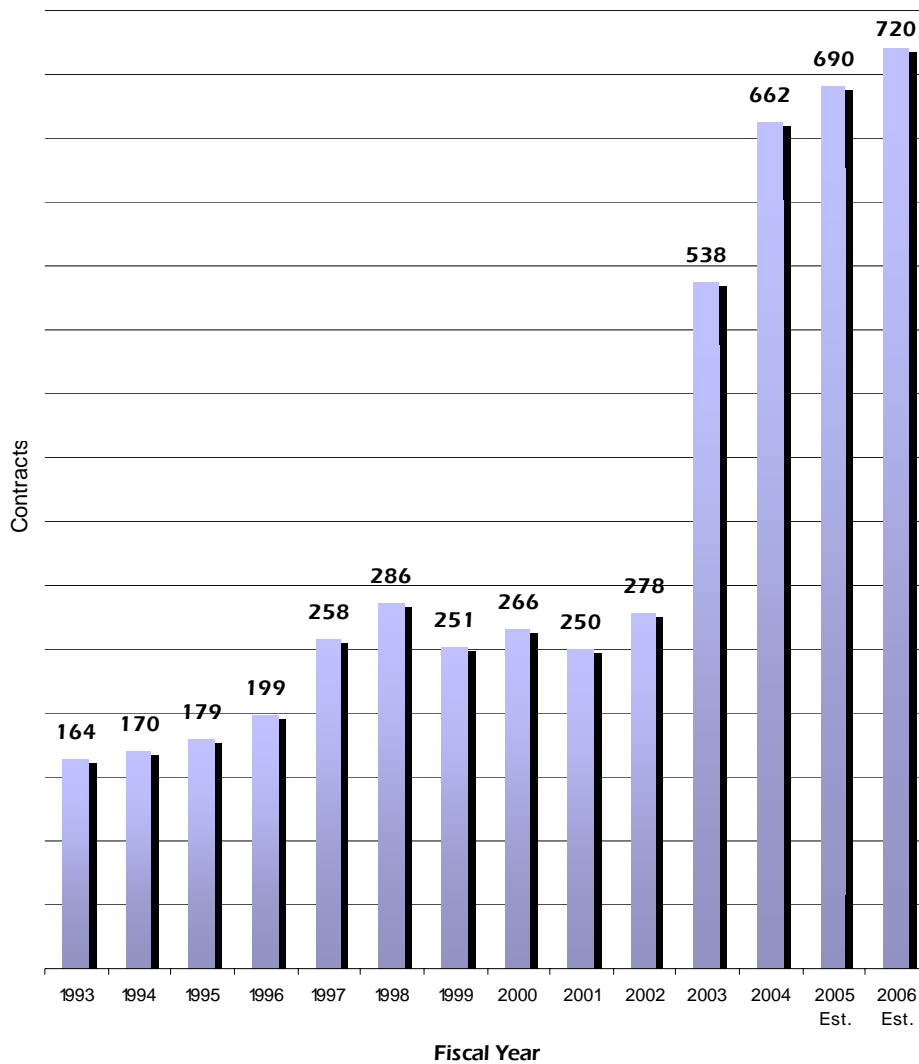


Figure 34: CFTC Actively Traded Contracts

Commodity Futures Trading Commission**Number of Registered Commodities Professionals**

Companies and individuals who handle customer funds or give trading advice must apply for registration through the NFA, an SRO to which the Commission has delegated that responsibility subject to CFTC oversight.

The Commission regulates the activities of nearly 69,000 registrants:

<u>Type of Registered Professional</u>	<u>Number in Sept 2004</u>
<i>Associated Persons (AP) (Sales People)</i>	<i>53,229</i>
<i>Commodity Pool Operators (CPOs)</i>	<i>1,871</i>
<i>Commodity Trading Advisors (CTAs)</i>	<i>2,677</i>
<i>Floor Brokers (FBs)</i>	<i>8,699</i>
<i>Floor Traders (FTs)</i>	<i>1,522</i>
<i>Futures Commission Merchants (FCMs)</i>	<i>215⁶</i>
<i>Introducing Brokers (IBs)</i>	<i><u>1,703⁷</u></i>
<i>TOTAL</i>	<i><u>69,916</u></i>

Table 16: Number of Registered Commodities Professionals

⁶ Includes 16 notice-registered FCMs.

⁷ Includes 40 notice-registered IBs.

Commodity Futures Trading Commission

Customer Funds in Futures Commission Merchants Accounts

From 1995 through 2004, the amount of customer funds held in FCM accounts has more than doubled.

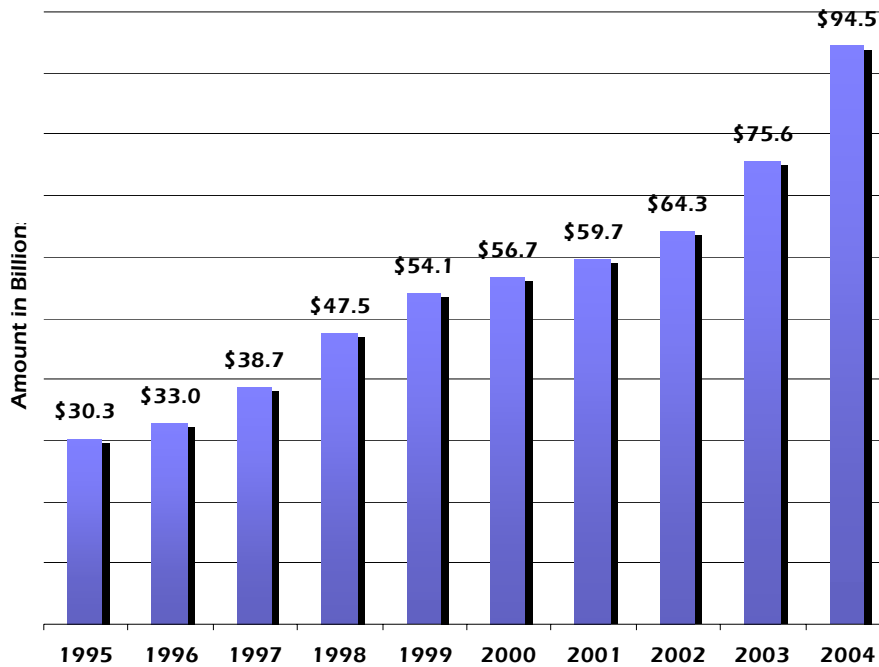


Figure 35: Customer Funds in FCM Accounts

Commodity Futures Trading Commission

CFTC-Regulated Commodity Exchanges *

Chicago, IL

- *Chicago Board of Trade (CBT)*
- *Chicago Mercantile Exchange (CME)*
- *OneChicago Futures Exchange (OCX)*
- *CBOE Futures Exchange (CFE)*
- *U.S. Futures Exchange, LLC (Eurex US)*
- *Chicago Climate Futures Exchange (CCFE)*

Kansas City, MO

- *Kansas City Board of Trade (KCBT)*

Minneapolis, MN

- *Minneapolis Grain Exchange (MGE)*

New York, NY

- *NQLX, LLC Futures Exchange (NQLX)*
- *New York Mercantile Exchange (NYMEX)*
 - Commodity Exchange Division (COMEX)
- *New York Board of Trade (NYBOT)*

Philadelphia, PA

- *Philadelphia Board of Trade (PBOT)*

San Mateo, CA

- *HedgeStreet, Inc. (HedgeStreet)*

* CFTC-regulated commodity exchanges include only exchanges with non-dormant contracts.

Commodity Futures Trading Commission

CFTC-Registered Derivatives Clearing Organizations

Chicago, IL

- *The Clearing Corporation (formerly the Board of Trade Clearing Corporation)*
- *Chicago Mercantile Exchange (CME) Clearinghouse*
- *The Options Clearing Corporation (OCC)*
- *Chicago Board of Trade (CBT)*

Kansas City, MO

- *Kansas City Board of Trade (KCBT) Clearing Corporation*

Minneapolis, MN

- *Minneapolis Grain Exchange (MGE) Clearinghouse*

New York, NY

- *New York Clearing Corporation (NYCC)*
- *New York Mercantile Exchange (NYMEX) Clearinghouse*

San Mateo, CA

- *HedgeStreet, Inc. (HedgeStreet)*

United Kingdom

- *London Clearing House (LCH)*

Commodity Futures Trading Commission

Summary of Goals, Outcomes, and Business Processes

Goal One: <i>Ensure the economic vitality of the commodity futures and option markets.</i>	
Outcome	Business Process
1.1 Markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.	<ol style="list-style-type: none"> 1. Conduct financial surveillance 2. Conduct market surveillance 3. Conduct trade practice surveillance 4. Conduct economic research 5. Review trading facility filings and clearing organization contracts and rules 6. Conduct cooperative enforcement 7. Investigate violations 8. File and prosecute cases 9. Take appropriate remedial or punitive action
1.2 Markets are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.	<ol style="list-style-type: none"> 1. Conduct financial surveillance 2. Conduct market surveillance 3. Conduct trade practice surveillance 4. Conduct economic research 5. Review trading facility filings and clearing organization contracts, and rules 6. Investigate violations 7. File and prosecute cases 8. Share information externally 9. Coordinate with domestic regulators
Goal Two: <i>Protect market users and the public..</i>	
Outcome	Business Process
2.1 Violations of Federal commodities laws are detected and prevented.	<ol style="list-style-type: none"> 1. Conduct financial surveillance 2. Conduct cooperative enforcement 3. Investigate violations 4. File and prosecute cases 5. Resolve administrative enforcement cases 6. Resolve appeals 7. Share information externally 8. Take appropriate remedial or punitive action 9. Represent Commission in litigation or other disputes 10. Collect monetary penalties from violators.
2.2 Commodity professionals meet high standards.	<ol style="list-style-type: none"> 1. Provide guidance, advice, and regulate business, financial, and sales practices 2. Review self-regulatory organizations and clearing organizations 3. Investigate, file, and prosecute cases

Goal Two: <i>Protect market users and the public. (Continued)</i>	
Outcome	Business Process
2.3 Customer complaints against persons or firms registered under the Act are handled effectively and expeditiously.	<ol style="list-style-type: none"> 1. Manage reparations program 2. Resolve appeals 3. Represent Commission in litigation or other disputes
Goal Three: <i>Ensure market integrity in order to foster open, competitive, and financial sound markets.</i>	
3.1 Clearing organizations and firms holding customer funds have sound financial practices.	<ol style="list-style-type: none"> 1. Conduct financial surveillance 2. Provide guidance, advice, and regulate business, financial, and sales practices 3. Review self-regulatory organization enforcement 4. Investigate violations 5. File and prosecute cases 6. Take appropriate remedial or punitive action
3.2 Commodity futures and option markets are effectively self-regulated.	<ol style="list-style-type: none"> 1. Conduct financial surveillance 2. Provide guidance, advice, and regulate business, financial, and sales practices 3. Review exchange applications, contracts, and rules 4. Review self-regulatory organization enforcement
3.3 Markets are free of trade practice abuses.	<ol style="list-style-type: none"> 1. Investigate violations 2. File and prosecute cases
3.4 Regulatory environment is flexible and responsive to evolving market conditions.	<ol style="list-style-type: none"> 1. Coordinate with domestic regulators 2. Coordinate with foreign and international regulators 3. Draft, review, and comment on legislation 4. Provide guidance, advice, and regulate business, financial, and sales practices

FY 2004 Program Performance Results by Goal⁸

Summary of Performance—Goal One

<i>Goal One: Ensure the economic vitality of the commodity futures and option markets.</i>			
Outcome 1.1: Futures and option markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of disruptive activity.			
Annual Performance Goal: No price manipulation of other disruptive activities that would cause loss of confidence or negatively affect price discovery or risk shifting.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage growth in market volume (<i>Growth in market volume</i>)	TBD	18%	24%
Percentage of novel or innovative market proposals or requests for CFTC action addressed within six months to accommodate new approaches to, or the expansion in, derivatives trading, enhance the price discovery process, or increase available risk management tools (<i>Expanding Infrastructure</i>)	N/A	TBD	TBD
Percentage increase in number of products traded (<i>Expanding number of products</i>)	TBD	13%	12%
Percentage of new exchange and clearinghouse applications completed within fast track review period	TBD	100%	100%
Percentage of new contract certification reviews completed within three months to identify and correct deficiencies in contract terms that make contracts susceptible to manipulation	TBD	55%	52%
Percentage of rule change certification reviews completed within three months, to identify and correct deficiencies in exchange rules that make contracts susceptible to manipulation or trading abuses or result in violations of law	TBD	70%	86%
Outcome 1.2: Markets are effectively and efficiently monitored to ensure early warning of potential problems or issues that could adversely affect their economic vitality.			
Annual Performance Goal: To have an effective and efficient market surveillance program.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage of DCO applications demonstrating compliance with core principles	100%	100%	100%
Ratio of markets surveilled per economist	TBD	TBD	10
Percentage of contract expirations without manipulation	99.9%	99.9%	99.9%

⁸ Final update of estimated actuals reported in the FY 2004 Performance and Accountability Report

Goal One

Office of the Chief Economist

The Office of the Chief Economist (OCE) performed economic and empirical analyses to evaluate the performance of futures markets and to evaluate the impact of changes in trading rules and in contract specifications on the performance of the futures markets. The office also provided economic and statistical consulting services to Commission staff and offered economic and financial research seminars and short courses in futures, options, and financial economics.

Staff also provided economic and statistical analysis to the Enforcement program on a number of cases involving foreign currencies and energy products and to the Market Oversight program on a review of the need for federal position limits for agricultural futures contracts and on several recently developed derivatives products.

During FY 2004, OCE staff presented research findings relating to price discovery, hedging and market microstructure and development issues at industry or academic conferences as well as through refereed academic journals.

Clearing and Intermediary Oversight

The Commission's Clearing and Intermediary Oversight program monitors the potential for, and instances of, market disruptions or emergencies related to: 1) the proper capitalization of firms; 2) the proper segregation of customer funds; or 3) issues with respect to systemic risk. Clearing and Intermediary Oversight staff monitor cases of volatile markets in order to advise the Commission of any potential impairment of a registrant or potential systemic risk. It is not possible to estimate in advance the number of such events that will occur annually because market volatility cannot be predicted. Nevertheless, such events are expected to occur. In this connection, Clearing and Intermediary Oversight staff conducted 34 market move reviews in FY 2004. Such reviews met the objectives of assuring that registrants and financial intermediaries are not impaired by market volatility or disruptions; and detecting any failure to meet clearinghouse obligations or other impairment of a registrant.

Enforcement

The Division of Enforcement undertakes several proactive and reactive steps in performance of its responsibilities under this goal. For example in FY 2004, and as detailed above, the Division continued its extensive investigation of alleged abuses in energy-related markets, including potential violations against false reporting, manipulation, and wash trading which culminated in the filing of 12 actions during that time period. The Commission also resolved pending manipulation cases against Norman Eisler and First West Trading, as well as its case against Enron Corp. (Enron) and Hunter S. Shively, who was the supervisor of the Central Desk of Enron's natural gas trading operation.

In its action against Enron and Shively, the Commission alleged that the defendants engaged in a scheme that manipulated the Henry Hub Spot Market, which in turn had a direct and adverse effect on NYMEX natural gas futures prices. Specifically, the complaint alleged that Enron and Shively used Enron's former web-based electronic trading platform, EOL, to buy an extraordinarily large amount of natural gas in a short period of time. The complaint further alleges that, immediately following the pre-arranged buying spree, Shively took various actions, including agreeing to cover trading losses of, and directing a payment from an account he controlled to, other traders involved in the scheme. As the

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complaint alleges, the manipulation of the Henry Hub Spot Market had a direct and adverse effect on the NYMEX August 2001 natural gas futures contract, including causing prices in NYMEX Henry Hub Futures to become artificial. Enron also offered an illegal agricultural futures contract on EOL between at least December 2000 and December 2001. Enron offered a product on EOL it called the US Financial Lumber Swap but, in fact, it was an agricultural futures contract that was not traded on a designated exchange or otherwise exempt. Therefore the contract was an illegal agricultural futures contract. On May 28, 2004, the Court entered a consent order of permanent injunction prohibiting Enron from violating various provisions of the CEA and ordered Enron to pay a \$35 million civil monetary penalty. On July 16, 2004, the Court entered a consent order of permanent injunction prohibiting Hunter Shively from violating provisions of the CEA and, pursuant to a settlement agreement between the Commission and Shively, Shively paid a civil monetary penalty of \$300,000.

Finally, although Commission investigations, as a statutory matter, are routinely conducted in a non-public format, the Commission did publicly announce its inquiry into a sharp upward movement in natural gas prices that occurred in late 2003.

Executive Direction & Support

Administrative Management & Support. In FY 2004, the Commission's primary mission critical application to support futures and option data market surveillance, the Integrated Surveillance System (ISS), has been significantly enhanced to address changes and growth in the futures industry. This year those changes included accepting markedly different contract markets that are traded on a new exchange, HedgeStreet and daily futures now being traded on the Chicago Mercantile Exchange. In addition, significant effort to improve the capability and availability of the ISS was executed through the implementation of over 12,000 system modifications and the implementation of a second data collection point for transmitted surveillance data to support continuity of operations.

Office of the General Counsel

In FY 2004, OGC continued to review for legal sufficiency and for conformance with the CEA and Commission policy and precedent contract market designation applications and applications for registration as derivatives transaction execution facilities (DTEFs) and DCOs.

In FY 2004, OGC continued to advise the Commission concerning implementation of the rules and regulations issued pursuant to the CFMA. OGC has been instrumental in advising the Commission as it comprehensively modernizes the rules governing market intermediaries such as FCMs, CPOs, CTAs and other registrants in light of the study completed by the Commission and submitted to Congress under Section 125 of the CFMA.

OGC also reviewed all proposed enforcement actions alleging manipulation and other abusive trading practices during FY 2004 to assure their legal sufficiency and conformance with Commission policy and precedent.

Market Oversight

Monitoring market activity represents one of the ways the Commission seeks to protect the economic functions of the markets. Market Surveillance is conducted to detect attempted manipulation and other abusive practices that could undermine the capacity of these markets to perform their economic function. The Commission takes preventive measures to ensure that market prices accurately reflect fundamental supply and demand conditions, including the routine daily

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monitoring of large trader positions, futures and cash prices, price relationships, and supply and demand factors in order to detect threats of price manipulation.

In FY 2004, the Market Surveillance subprogram conducted daily surveillance of 556 active futures and option markets. Particularly close monitoring was conducted on the energy futures markets, which experienced periods of high prices and high price volatility due to, among other things, low stocks, geopolitical tension in the Middle East, and strong world economic demand. In addition, very close monitoring was conducted on the cattle futures markets as prices were volatile due to the countervailing pressures of strong demand and the effects of discovery of BSE disease in a single cow in Washington State. The surveillance included collecting and analyzing approximately 35.3 million line items of data regarding large trader activity and approximately 17,035 reports identifying the large traders. In the course of the year, economists prepared approximately 1,850 weekly surveillance reports and compiled 26 special market reports.

The Market and Product Review staff reviewed two applications of entities seeking to become designated contract markets. The Market and Product Review staff also reviewed three filings by entities that notified the Commission of their intention to operate as exempt markets under the CEA.

The Market and Product Review staff conducted due diligence reviews of designated contract markets' new product filings to ensure that the contracts are not readily susceptible to manipulation. In FY 2004, the exchanges submitted 207 filings to list new futures and option contracts. Of the 207 contracts filed, 3 were submitted for Commission approval, and 204 were submitted under exchange self-certification procedures. Many of the new products were innovative. For example, of the 204 contracts filed under certification procedures, 22 contracts were binary options listed for trading on HedgeStreet, a newly-designated contract market. Staff reviewed the terms and conditions of contracts submitted under certification procedures to ensure that statutory and regulatory anti-manipulation requirements were met and to provide essential background information in order to conduct market surveillance.

The Commission's review of exchange rules is a key aspect of the statutory framework for self-regulation under Commission oversight. The Market and Product Review staff reviewed the terms and conditions of contracts submitted for approval to ensure that the contracts' terms and conditions were in compliance with Commission regulations and policies and did not raise any public interest issues. Staff reviewed the terms and conditions of contracts submitted under certification procedures to ensure that statutory and regulatory anti-manipulation requirements were met and to provide essential background information in order to conduct market surveillance. In that regard, in FY 2004, the Market and Product Review staff processed 323 amendments to contract terms and conditions for existing futures and option contracts, including 140 amendments that were economically significant. Eighteen of those economically significant rule changes were submitted for Commission review and approval, while 122 rule changes were filed under exchange self-certification procedures. The staff subprogram also reviewed exchange rule submissions with a view toward maintaining the fairness and financial integrity of the markets, protecting customers, accommodating and fostering innovation, and increasing efficiency in self-regulation consistent with the Commission's statutory mandates. Also in FY 2004, the Market and Product Review staff processed 263 exchange submissions, involving 2,669 new rules and rule amendments. Ten of the submissions were submitted for Commission approval, while 252 submissions were filed under exchange self-certification procedures.

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The Market and Product Review subprogram is also responsible for providing exemptive, interpretive, or other relief to various markets and market participants to facilitate the continued development of an effective, flexible regulatory environment responsive to evolving market conditions. Most significantly, during the year staff issued no-action relief to four foreign exchanges seeking to place electronic trading terminals in the U.S. without contract market designation.

Office of Proceedings

The Office of Proceedings continued to hear and decide statutory disqualification actions brought by the Commission.

Summary of Performance—Goal Two

<i>Goal Two: Protect market users and the public.</i>			
Outcome 2.1: Violations of Federal commodities laws are detected and prevented.			
Annual Performance Goal: Violators have a strong probability of being detected and sanctioned.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Number of enforcement investigations opened during the fiscal year	120	120	215
Number of enforcement cases filed during the fiscal year	60	60	83
Percentage of enforcement cases closed during the fiscal year in which the Commission obtained sanctions (e.g., civil monetary penalties, restitution and disgorgement, cease and desist orders, permanent injunctions, trading bans, and registration restrictions)	100%	99%	99%
Cases filed by other criminal and civil law enforcement authorities during the fiscal year that included cooperative assistance from the Commission	20	20	20
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage of SROs that comply with core principles	New	100%	100%
Percentage of DCOs that comply with core principles	100%	100%	100%
Percentage of professionals complaint with standards regarding testing, licensing, and ethics training (<i>Professional compliance</i>)	100%	100%	89%
Percentage of SROs that comply with requirement to enforce their rules	100%	100%	100%
Percentage of total requests receiving CFTC responses for guidance and advice	90%	90%	100%
Outcome 2.3: Customer complaints against persons or firms registered under the Act are handled effectively and expeditiously.			
Annual Performance Goal: Customer complaints are resolved within one year from the date filed and appeals are resolved within six months.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage of filed complaints resolved within one year of the filing date	50%	50%	41%
Percentage of appeals resolved within six months	35%	35%	35%

Goal Two

Clearing and Intermediary Oversight

Oversight of Sales Practices and Registered Futures Associations. A core part of the Commission's mission is to operate a program that protects market users and the public from fraud and abusive practices related to the offer and sale of commodity futures and options. The Clearing and Intermediary Oversight program conducts ongoing oversight related to screening market professionals for fitness and assuring that DCOs have appropriate risk management programs. The Clearing and Intermediary Oversight program also develops disclosure standards, particularly for managed futures and option products, to assure that market users and potential market users are appropriately and consistently informed of the risks of futures and option trading as well as important background information about trading managers.

The Clearing and Intermediary Oversight program oversees the NFA's Disclosure Document Review program for CPOs and CTAs. Pursuant to a March 2003 delegation of authority by the Commission to the NFA, the program now includes oversight of NFA reviews of disclosure documents filed by CPOs for publicly offered commodity pools. Further, pursuant to a December 2002 delegation of authority by the Commission to the NFA, the program now includes oversight of NFA reviews of annual reports by CPOs for commodity pools that they operate. Commission staff has frequent contact with NFA staff to coordinate regulatory efforts.

Oversight of Intermediary Fitness. In FY 2004, there were 69,916 industry registrants. These registrants included 215 FCMs (16 of which were notice-registered), 1,703 IBs (40 of whom were notice-registered), 1,871 CPOs, and 2,677 CTAs. These firms employ 53,229 sales personnel, known as APs. In addition, there are 8,699 individuals registered as floor brokers (FBs) and 1,522 individuals registered as floor traders executing trades on U.S. exchanges.

The Clearing and Intermediary Oversight program is responsible for performing the Commission's formal oversight of the NFA registration program. This oversight involves inspection of records and interviews with NFA staff as well as numerous informal contacts between NFA and the Clearing and Intermediary Oversight program on a weekly basis. These oversight activities are designed to protect market participants and the public interest by assuring that persons who deal directly with customers and those who handle customer orders and customer funds meet the standards for fitness, integrity, and training established under the CEA. Persons who cannot meet these standards may be subject to statutory disqualification from registration and may have their registration denied, conditioned, or revoked.

The Clearing and Intermediary Oversight program seeks to protect market users and the public by requiring futures industry professionals to meet high standards through registration and passing of a proficiency exam by salespersons. A performance measure established to indicate the percentage of professionals compliant with standards regarding testing, licensing, and ethics training shows that in FY 2004 the program reached 100 percent. When Commission staff uncover persons who are not registered but should be, a letter is sent to the person, and/or the matter is referred for enforcement action.

The Clearing and Intermediary Oversight program chaired the Registration Working Group (RWG), which is composed of Commission and NFA representatives. The RWG was created as a means for the Commission and NFA staff to

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share ideas and concerns about issues that are not tied to any specific pending registration case. Commission staff participated in four meetings of the RWG during FY 2004, in which the group discussed among other things: 1) registration holds; 2) permitting oral hearings as part of the process of determining whether to suspend a person's registration for willful failure to disclose a criminal matter; 3) the impact of a new Illinois statute on registration under the Act; 4) Rule 30.5 exemptions from Commission registration; and 5) fingerprint processing.

Anti-Money Laundering. Clearing and Intermediary Oversight staff worked with representatives of other Commission units and other federal financial regulators on various aspects of a program to combat money laundering and terrorist financing. Specifically, staff worked with Treasury in developing suspicious activity reporting and customer identification rules applicable to FCMs and IBs. The suspicious activity reporting rule applies to transactions occurring after May 18, 2004. Staff also worked with Treasury in developing proposed AML program rules for CTAs, IAs and unregistered investment companies. The final rules are currently being developed. Staff also worked with the SEC and other agencies in drafting staff interpretations of the customer identification and verification rules and a proposed no-action position concerning the customers of certain CTAs and IAs. The first tier of the interpretations was issued on June 14, 2004. Staff also continues to work with Treasury in a process for sharing information about possible terrorists and money launderers. As part of this process, Commission staff maintains and updates a list of FCMs and contact persons, which Treasury then uses when issuing a list of possible money launderers and terrorists on a biweekly basis.

The Major Reviews unit, one of two new units within the Division, was created during FY 2004 to, in addition to managing major risk-focused reviews of exchanges and clearinghouses, develop and review standards for the evaluation and audit of registrant compliance with AML requirements applicable to FCMs, IBs, CPOs, and CTAs.

Enforcement

Forex Cases. The Commission's work in fighting fraud in FY 2004 continued in the forex trading arena. During FY 2004, the Commission filed a total of 23 enforcement actions in this program area:

- *CFTC v. A.S. Templeton Group, Inc.*, NO. 03 4999 (E.D.N.Y. filed Oct. 1, 2003)
- *CFTC v. FX First, Inc., et al.*, No. SACV 03-1454-JVS(MLGx) (C.D.Cal. Filed Oct. 6, 2003);
- *CFTC v. Bibas Levy Corp., et al.*, No. 03-22624 (S.D.Fla. Oct. 7, 2003)
- *CFTC v. Rowell*, CFTC Docket No. 04-02 (CFTC filed Oct. 15, 2003)
- *CFTC v. First Lexington Group, LLC, et al.*, No. 03 CV 9124 (S.D.N.Y. Nov. 18, 2003)
- *CFTC v. Bursztyn, et al.*, No. 03 CV 9125 (S.D.N.Y. Nov. 18, 2003)
- *CFTC v. Walter, Scott, Lev & Associates, LLC, et al.*, No. 03 CV 9126 (S.D.N.Y. filed Nov. 18, 2003)
- *CFTC v. ISB Clearing Corp., et al.*, No. 03 CV 9127 (S.D.N.Y. filed Nov. 18, 2003)

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- *CFTC v. Madison Deane & Associates, Inc., et al.*, No. 03 CV 9128 (S.D.N.Y. filed Nov. 18, 2003)
- *CFTC v. Itradecurrency USA LLC, et al.*, No. 03 CV 9129 (S.D.N.Y. filed Nov. 18, 2003)
- *CFTC v. Emerald Worldwide Holding, Inc., et al.*, No. CV03-8339 AHM(Ex) (C.D.Cal. filed Nov. 17, 2004)
- *In re Yost, et al.*, CFTC Docket No. 04-07 (CFTC filed Dec. 22, 2003)
- *CFTC v. Erskine, et al.*, No. 1:04oV0016 (N.D.Ohio filed Jan. 6, 2004)
- *CFTC v. Clearview Capital Mgt., et al.*, NO. 04cv45(FSH) (D.N.J. filed Jan. 8, 2004)
- *CFTC v. Gibraltar Monetary Corp., et al.*, No. 04-80132 (S.D.Fla. Filed Feb. 10, 2004)
- *CFTC v. FxTrade Financial, LLC, et al.*, No. 04-2181-Dan (W.D.Tenn. Filed March 17, 2003)
- *CFTC v. E Net Speculation Ltd., et al.*, No. 3:04CV169-s (W.D.Ky. Filed March 19, 2004);
- *CFTC v. Calvary Currencies LLC, et al.*, NO. 8:04-CV-01021-DKC (D.Md. Filed March 29, 2004)
- *CFTC v. Lexington Royce & Associates*, No. 04 CV 02768 (S.D.N.Y. filed April 12, 2004)
- *CFTC v. Axess Trade Co., Inc.*, No. 04 CV 4293 (S.D.N.Y. filed June 7, 2004)
- *CFTC v. Sterling Financial Group, Inc.*, No. 04-21346 CIV-LENARD (S.D.Fla. filed June 7, 2004)
- *CFTC v. Next Financial Services Unlimited, Inc., et al.*, No. 04-80562 CIV-RYSKAMP (S.D.Fla. June 21, 2004)
- *CFTC v. Global Atlantic Management, Inc., et al.*, No. 04-60797 CIV-JORDAN (S.D.Fla. filed June 21, 2004)

During FY 2004, the Commission also achieved significant litigation results in 12 actions filed in this practice area during previous fiscal years:

- *CFTC v. Hawker, et al.*, No. 2:03 CV 0260 JTG Consent Order Of Permanent Injunction And Other Equitable Relief [Against Bryan Keith Hawker and G, Hawker & Stone, LLC] (D.Utah entered Oct. 24, 2003) (forex fraud case filed March 12, 2003; permanent injunction; restitution and civil monetary penalty reserved for further proceedings)
- *CFTC v. Offshore Financial Consultants, Inc, et al.*, NO. 02-60769-CIV-MORENO, Default Final Judgment (S.D.Fla. entered Nov. 10, 2003) (forex fraud case filed April 30, 2001; permanent injunction against Anthony Garcia and James Sexton; civil monetary penalties against Garcia (\$360,000) and Sexton (\$360,000))

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- *CFTC v. A.S. Templeton Group, Inc.*, NO. 03 4999, Order Of Permanent Injunction (E.D.N.Y. entered Nov. 24, 2003) (forex fraud case filed Oct. 1, 2003; permanent injunction (Michael Vitebsky and Boris Shuster))
- *CFTC v. World Banks Foreign Currency Traders, Inc. et al.*, No. 01-7402, Consent Order Of Permanent Injunction And Other Equitable Relief Against Defendants Frank Desantis, Christopher Boutche And Erin Valko (S.D. Fla. entered Jan. 20, 2004) (forex fraud case filed August 23, 2001; permanent injunction; \$600,000 total restitution (DeSantis & Boutchie \$300,000 each))
- *CFTC v. Elsesser, et al.*, No. 8:03-CV-681-T-23TBM Consent Order Of Permanent Injunction And Other Equitable Relief Against Defendant Keith Elsesser (M.D.Fla. entered Jan. 26, 2004) (forex fraud case filed April 11, 2003; permanent injunction; \$73,507 restitution; \$120,000 civil monetary penalty)
- *CFTC v. Fintrex, Inc., et al.*, No. CV 01-06907 PA (CWx), Final Order Of Default Judgment Against Fintrex, Inc., And Arman Ovsepyan (C.D.Cal. entered Jan. 29, 2004) (forex fraud case filed August 9, 2001; permanent injunction; \$1,320,283 (Fintrex), and \$683,670 (Fintrex and Ovsepyan, jointly and severall) restitution; \$4,007,906 (Fintrex) and \$1,367,340 (Ovsepyan) civil monetary penalties; and pursuant to the court's December 12, 2002 civil contempt order, Ovsepyan is further ordered to return funds to Fintrex of \$170,012 and make an accounting of disposition of other assets)
- *CFTC v. Bibas Levy Corp., et al.*, No. 03-22624, Final Default Judgment (S.D.Fla. entered April 16, 2004) (forex fraud case filed October 7, 2003; \$351,686 restitution; \$100,013 disgorgement; \$120,000 civil monetary penalty; monetary penalties to be paid jointly and severally by Bibas Levy Corp., Zacarias Bibas, and Hassan Sharam)
- *CFTC v. Noble Wealth Data Information Services, Inc., et al.*, No. PJM 98-3316, Settlement Order (D.Md. entered May 14, 2004) (forex fraud case filed October 1, 1998; permanent injunction against Esfand Baragosh; \$5,264,251 restitution; \$1,211,058 civil monetary penalty)
- *CFTC v. Eurobancorp, et al.*, No. 03-767 SJO (JWJx) Orders Of Permanent Injunction And Other Equitable Relief Against Defendants Paris DeLesseppes, and John Lassen (C.D.Cal. entered May 21 and 28, 2004) (forex fraud case filed February 3, 2003; permanent injunction; \$333,769 (Lassen) and \$333,769 (DeLesseppes) restitution; \$240,000 (Lassen) and \$240,000 (DeLesseppes) civil monetary penalties)
- *CFTC v. International Financial Services (New York), Inc., et al.*, No. 02 Civ. 5497 (GEL), Final Judgment [Against All Defendants] (S.D.N.Y. entered May 26, 2004) (forex fraud case filed July 17, 2002; permanent injunction; \$25,428,840 (jointly and severally) restitution and disgorgement; and \$76,286,520 (jointly and severally) civil monetary penalty)
- *CFTC v. O'Neill, et al.*, No. 02-61307-Civ-Gold, Order of Permanent Injunction and Supplemental Order Of Judgment On Restitution And Civil Monetary Penalties Against [Donald O'Neill and Danielle O'Neill] (S.D. Fla. entered Nov. 14, 2003 and June 15, 2004) (forex

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fraud case filed September 17, 2002; permanent injunction; \$11,519,660 restitution; \$10,609,133 civil monetary penalty)

- *CFTC v. Wheeler, et al.*, No. 6:03CV42, Consent Orders Of Disgorgement As To Relief Defendants Mendoza, Gary Wood, Michael Fagan, and Walter Cole (E.D.Tex. entered June 4, 15 and 16, 2004) (forex fraud case filed January 30, 2003; ordered disgorgement of \$50,000 (Mendoza), \$92,000 (Fagan), \$318,170 (Cole), and \$500,000 (Wood))

Commodity Pools, Hedge Funds And Commodity Pool Operators. During FY 2004, the Commission filed six enforcement actions in this program area:

- *CFTC v. Marquis Financial Mgt. Systems, Inc., et al.*, No. 03-74206 (E.D.Mich. Filed Oct. 20, 2003)
- *CFTC v. Friedlander, et al.*, No. 03 CV 8319 (S.D.N.Y. filed Oct. 21, 2003)
- *CFTC v. Boston Trading Advisors, LLC, et al.*, CFTC Docket No. 04-03 (CFTC filed Oct. 27, 2003)
- *CFTC, et al. v. Silberstein*, No. 1:04-CV-666 (D.Md. Filed March 5, 2004); *CFTC v. Equity Financial Group LLC, et al.*, No. 04CV1512 (D.N.J. filed April 1, 2004)
- *CFTC v. Weatherford*, No. CV04-4079 SJO(CWz) (C.D.Cal. filed June 8, 2004)
- *CFTC v. Vanguard Financial Mgt. Assoc., et al.*, No. SAVC 04-575(GLT) (C.D.Cal. filed May 19, 2004)

During FY 2004, the Commission also achieved significant litigation results in four actions filed in this practice area during previous fiscal years:

- *CFTC v. Brockbank, et al.*, No. 2:00 CV 00622ST, Consent Order Of Permanent Injunction And Other Ancillary Relief Against Defendant Thomas E. Jones (D.Utah entered Oct. 30, 2003) (commodity pool fraud case filed August 8, 2003, amended January 16, 2003; permanent injunction; \$74,000 restitution)
- *CFTC v. Mady et al.*, No. 02-72364, Consent Order Of Permanent Injunction And Other Equitable Relief And A Civil Monetary Penalty Against Defendant Charles G. Mady (E.D. Mich. entered Nov. 6, 2003) (pool fraud case filed June 11, 2002; permanent injunction; undertaking to not seek registration and to not trade for 10 years; \$8,220,860 restitution; \$8,220,860 civil monetary penalty with dollar for dollar credit for payment towards restitution)
- *CFTC v. Chilcott, et al.*, No. 2:02-cv-94-FtM-29SPC, Order [Against Ted E. Whidden] and Supplemental Consent Order Concerning Restitution And Civil Monetary Penalty Against Defendants Thomas D. Chilcott And Leona Westbrook (M.D.Fla. entered Dec. 16, 2003, and January 6, 2004) (commodity pool fraud case filed March 6, 2002; \$2,279,521 restitution (joint and several by Whidden, Chilcott and Westbrook); civil monetary penalties of \$1,320,000 (Chilcott) and \$110,000 (Westbrook))

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- *CFTC v. Sovereign Resource Management, Inc., et al.*, No. 02-1783 Order Of Default Judgment For Permanent Injunction And Other Ancillary Relief Against Defendants Sovereign Resource Management, Inc., Ken Mitra and Virgil E. Smith (D. Minn. entered March 26, 2004) (commodity pool fraud case filed July 18, 2002; permanent injunction; \$3,127,752 restitution (joint and several); civil monetary penalties of \$550,000 (Sovereign), \$660,000 (Mitra) and \$440,000 (Smith))

Commodity Trading Advisors, Managed Accounts, And Trading Systems. The Commission filed four enforcement actions in this program area during FY 2004:

- *CFTC v. Matrix*, CFTC Docket No. 04-01 (CFTC filed Oct. 2, 2003)
- *In re Harrison*, CFTC Docket No. 04-04 (CFTC filed Nov. 18, 2003)
- *CFTC v. Profit Partners, Inc.*, No. CV03-9190 (C.D.Cal. filed Dec. 16, 2003)
- *In re Allen*, CFTC Docket No. 04-14 (CFTC filed April 9, 2004)

During FY 2004, the Commission also achieved significant litigation results in two actions filed in this practice area during previous fiscal years:

- *CFTC v. Lee, et al.*, No. 4:02CV 01477 CAS, Consent Order Of Permanent Injunction And Other Equitable Relief And A Civil Monetary Penalty Against Defendants Kenneth J. Lee And KJL Financial Group, Inc. (E.D. Mo. ordered March 9, 2004) (managed accounts case filed September 30, 2002; permanent injunction; restitution \$567,551 (joint and several); \$300,000 civil monetary penalty (Lee)); and
- *CFTC v. Goldman*, No. 03-3265 JFW (RCx), Consent Order Of Permanent Injunction And Other Equitable Relief Against Defendant Oscar Goldman (C.D.Cal. entered April 1, 2004) (CTA fraud case filed May 9, 2003; permanent injunction; \$95,500 disgorgement; \$180,000 civil monetary penalty).

Futures Commission Merchants and Introducing Brokers. The Commission diligently redresses fraud, misappropriation and other violative conduct by FCM and IBs. The Commission's efforts in this program area during FY 2004 include: *CFTC v. Keith Wilson Krynski*, Civil Action No. 03C 8571 (N.D. Ill. November 26, 2003) Defendant ordered to pay more than \$350,000 in restitution and to pay a \$60,000 civil monetary penalty; *CFTC v. Thomas D. Chilcott, d/b/a Trade Master of Southwest Florida, Ted E Whidden, and Leona Westbrook*, Civil Action No. 2:02-cv-94-FtM-29SPC (M.D. Fla. January 6, 2004). Defendants Chilcott and Westbrook ordered to pay \$2.1 million in restitution and more than \$1.43 million in civil monetary penalties, and defendant Whidden ordered to share liability for repaying customers and to pay a civil monetary penalty of \$990,000; *In re Steven G. Soule, Kyler F. Lunman II and Hold Trade Inc.* (CFTC February 11, 2004). Soule, Lunman and Hold Trade were ordered to pay \$276,557 in restitution to Coastal. Soule was ordered to pay a civil monetary penalty of \$276,000, and was permanently banned from trading; and Lunman and Hold Trade were ordered to pay a civil monetary penalty of \$250,000, Lunman was banned from trading for ten years, and Hold Trade was permanently banned from trading; *CFTC v. Kenneth Lee and KJL Financial Group, Inc.*, Case No. 4:02-cv-1477 CAS (E.D.MO. September 30, 2002). Defendants ordered to

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pay \$567,000 in restitution and to pay a civil monetary penalty of \$300,000; *CFTC v. Oscar Goldman*, Case No. CV-03-3265 JFW (RCx) (C.D.CA. May 9, 2003). Defendant ordered to pay \$95,500 to customers and to pay a civil monetary penalty of \$180,000; *In re Roy M. Sidewitz and Qi2 Technologies, Inc.*, Docket No. 03-18 (April 6, 2004). Respondents ordered to pay a \$25,000 civil monetary penalty; *CFTC v. E Net Speculation Ltd., Patrice Cornaz, and Athos Socratous*, Case No. 3:04-CV-169-S (W.D. KY March 19, 2004); *CFTC v. Commercial Hedge Services, Prime Trading Company and Lawrence Joseph Volf* (D. Neb. May 4, 2004). Defendants enjoined from violating provisions of the CEA and required to provide written disclosures to the farmers regarding their trading strategy; *In re William Scott Cordo and Mitchell Stephen Davis and First Investors Group of the Palm Beaches, Inc.* (CFTC May 24, 2004). defendants ordered Cordo to pay a \$480,000 civil monetary penalty and Davis to pay a \$120,000 civil monetary penalty; *CFTC v. First American Investment Services, Inc., Steve Knowles, Michael Savitsky, Greg Allotta, Adam Mills and James Eulowith*, Case No. CV04-60744 (S.D. FL June 7, 2004). Commission charged that defendants fraudulently solicited customers to trade options on commodity futures. The Commission alleged that customers lost more than \$12 million trading commodity options in 2002 and 2003, including more than \$6 million in commissions; *In re Harold Ludwig, William Rogers and Maria Toczykowski*, Docket Nos. 04-19 and 20 (CFTC July 13, 2004). Commission ordered defendants to pay more than \$11 million in restitution and more than \$4 million in civil monetary penalties for aiding and abetting a Ponzi scheme; *CFTC v. Carnegie Trading Group, Ltd., Inc., John Glase, John Hollenbaugh and Reid Henshaw*, Docket No. 1:04CV1403 (CFTC July 23, 2004). Commission charges defendants with customer solicitation fraud, including distribution to certain customers of a false and misleading advertisement regarding a proposed trading program; *CFTC v. Worldwide Commodity Corporation, Steven Labell, Joseph L. Allen, Bruce N. Crown and Phil Ferrini*, Case No. 04-CV-0461 (E.D. PA August 2, 2004). Commission charged that defendants fraudulently solicited customers to trade commodity options, resulting in customer losses of more than \$4 million; *CFTC v. Chase Commodities Corporation, Lee Lagorio and Excel Obando*, Case No. CV04-6463 (C.D. CA August 4, 2004). Commission complaint alleges that defendants fraudulently solicited customers to trade options on commodity futures contracts, resulting in customer losses of more than \$4 million, including more than \$2 million in commissions; *CFTC v. International Funding Association, et al.*, Case No. CV03-1826 (D. Ariz. July 29, 2004). The Commission had filed an action charging that, since 1997, Holt and his companies had defrauded customers of as much as \$25 million by claiming returns of seven percent to 10 percent per month, when the defendants, instead, allegedly misappropriated most customer funds and also had offered illegal off-exchange futures contracts to the public; *CFTC v. Wilshire Investment Management Corporation, Andrew Alan Wilshire, Eric Scott Malcolmson, James Joseph Russo, and National Commodities Corporation, Inc.*, Case No. CV04-80862 (S.D. FL. September 14, 2004); *CFTC v. Liberty Financial Trading Corp., et al.*, Case No. 04-61235 (SD Fl. September 21, 2004). Complaint alleges that defendants fraudulently solicited customers to trade commodity options contracts; *In re Steven Matrix* (CFTC October 7, 2003). The Commission accepted respondent Steven Matrix's offer of settlement and ordered him to pay a \$15,000 civil monetary penalty. Complaint alleged that respondent fraudulently solicited clients through his Web site to purchase a trading system manual with chart updates and e-mail support, by representing that he had actually earned profits while trading commodity futures according to that system when, in fact, he had not; and *CFTC v. Stephen A. Schmidt, TradeWins Publishing Corp., Shri Krishna Investment Research Corporation, and Anand Inamdar*, Case No. CV04-3081 (E.D.N.Y. July 20, 2004). Complaint alleges that defendants fraudulently promoted a trading system, including representations that trades posted on the Web site were actual trades. The complaint also charged that, by

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means of the alleged false claims, Schmidt and TradeWins violated a prior CFTC consent order issued against them in April 2002.

Statutory Disqualifications. During FY 2004, the Commission filed three enforcement actions in this program area:

- *In re FX First, Inc.*, CFTC Docket No. SD 04-01 (CFTC filed Feb. 18, 2004)
- *In re VanPatten*, CFTC Docket No. SD 04-02 (CFTC filed March 25, 2004)
- *In re Anixter*, CFTC Docket No. SD 04-03 (CFTC filed June 30, 2004)

Quick Strike Cases. The Commission is committed to responding quickly to enforcement investigations that uncover ongoing fraud. Quick-strike cases are civil injunctive actions that generally are filed in Federal district courts within days or weeks of the discovery of the illegal activity, enabling the Commission to stop fraud at an early stage and to attempt to preserve customer funds. Through the third quarter of FY 2004, the Commission filed the following ten quick-strike cases:

- *CFTC v. Bibas Levy Corp., et al.*, No. 03-22624 (S.D.Fla. Oct. 7, 2003) (forex fraud)
- *CFTC v. Krysinksi*, No. 03C 8571(N.D.Ill. Filed Nov. 26, 2003) (FCM fraud)
- *CFTC v. Profit Partners, Inc.*, No. CV03-9190 (C.D.Cal. filed Dec. 16, 2003) (commodity trading system fraud)
- *CFTC v. Silberstein*, No. 1:04-CV-666 (D.Md. filed March 5, 2004) (CPO fraud)
- *CFTC v. FxTrade Financial, LLC, et al.*, No. 04-2181-Dan (W.D.Tenn. filed March 17, 2003) (forex fraud)
- *CFTC v. Lexington Royce & Associates*, No. 04 CV 02768 (S.D.N.Y. filed April 12, 2004) (forex fraud)
- *CFTC v. Vanguard Financial Mgt. Assoc., et al.*, No. SAVC 04-575(GLT) (C.D.Cal. filed May 19, 2004) (CPO fraud)
- *CFTC v. Weatherford*, No. CV04-4079 SJO(CWz) (C.D.Cal. filed June 8, 2004) (CPO fraud)
- *CFTC v. Next Financial Services Unlimited, Inc., et al.*, No. 04-80562 CIV-RYSKAMP (S.D.Fla. June 21, 2004) (forex fraud)
- *In re Anixter*, CFTC Docket No. SD 04-03 (CFTC filed June 30, 2004) (statutory disqualification)

Domestic Cooperative Enforcement. The Commission's cooperative enforcement efforts are an important part of its ability to promote compliance with and deter violations of Federal commodities laws. Cooperative enforcement enables the Commission to maximize its ability to detect, deter, and impose sanctions against wrongdoers involving U.S. markets, registrants, and customers. The benefits of

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cooperative enforcement include: 1) the use of resources from other sources to support Commission enforcement actions; 2) coordination in filing actions with other authorities to further the impact of enforcement efforts; and 3) development of consistent and clear governmental responses and avoidance of duplication of efforts by multiple authorities.

As in the past, staff of the Enforcement program have coordinated with numerous Federal, state, and self-regulatory authorities. Historically, program staff have sought assistance from or provided assistance to various Federal agencies, such as the Department of Justice (DOJ), Federal Bureau of Investigation (FBI), SEC, the U.S. Postal Inspection Service, and the Internal Revenue Service (IRS). Similarly, Division staff have provided assistance to and/or received assistance from state authorities, such as agencies responsible for the regulation of corporations, securities, and banking. The Commission also has provided Federal and local law enforcement authorities with testimony or other assistance in connection with criminal investigations. Division staff have worked with the DOJ and various U.S. Attorney's offices throughout the Nation, the FBI, the offices of numerous state attorneys general, local police authorities, and task forces focusing on areas such as corporate fraud and forex fraud.

Although the Commission cannot publicly describe the nature of the assistance obtained or given in connection with pending investigations, the following is a sampling of results in cooperative enforcement cases during the past year in which the Enforcement program coordinated its efforts with domestic authorities. These cooperative enforcement cases fall into three general categories: 1) criminal actions in which the Enforcement program provided testimony or other support; 2) matters in which the Commission worked with other criminal or civil authorities and they filed parallel actions; and 3) Commission enforcement actions for which the Commission received assistance from other authorities.

Other Cooperative Enforcement Efforts. In addition to direct cooperation with domestic law enforcement and regulatory authorities, the Enforcement program also represents the Commission in a variety of domestic and international efforts, including task forces and working groups designed to keep market participants abreast of new developments in financial crimes and to coordinate governmental responses to common issues. Several examples of the efforts of the Enforcement program in this area follow:

- *Corporate Fraud Task Force.* By Executive Order signed by President Bush on July 9, 2002, the CFTC was named as a member of the Corporate Fraud Task Force. This task force was established with the objective of strengthening the efforts of DOJ, Federal, state, and local agencies to investigate and prosecute significant financial crimes, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetrate financial crimes. Recent efforts of this inter-agency cooperative task force have included an investigation of the alleged manipulation of the energy markets during the power crisis of 2000 to 2001.
- *National Futures Association Assistance.* During FY 2004, the NFA continued to provide invaluable assistance to Commission's Enforcement program in two of its most important program areas: its investigation into the alleged misconduct in the energy markets and its investigation of forex trading fraud. NFA's assistance included detailing a number of its employees to work shoulder-to-shoulder with Division staff on these matters. The detailees' expertise, enthusiasm and hard work were an invaluable asset to the Enforcement

program and are a proud reflection of the NFA's professionalism and commitment.

- *Anti-Money Laundering.* The Commission participates in domestic and international AML cooperative enforcement efforts. On the domestic front, the Commission is a member of the Money Laundering Strategy Working Group and the U.S. Treasury Department's Bank Secrecy Act Advisory Group, and Commission staff are consulting with staff of the U.S. Treasury Department in developing regulations as required by the USA PATRIOT Act enacted in response to the terrorist attacks of September 11, 2001. Internationally, the Commission has aided the U.S. delegation to the Financial Action Task Force, including its efforts to combat global terrorist financing.
- *Telemarketing and Internet Fraud Working Group.* The Telemarketing and Internet Fraud Working Group consists of representatives from state, Federal, and international regulatory and criminal authorities. At the working group's quarterly meetings, members discuss all aspects of telemarketing and Internet fraud, including issues such as new scams, new uses of technology, geographical hotspots for certain types of fraudulent activity, effective enforcement techniques, and recent cases that establish relevant precedent in this area.
- *Consumer Protection Initiatives Committee.* The Consumer Protection Initiatives Committee was created by the Attorney General's Council on White-Collar Crime to coordinate activities of various agencies' consumer protection programs. Goals of the committee include: 1) minimizing duplication of consumer protection efforts by sharing information on various fraud prevention and enforcement initiatives; 2) developing interagency consumer protection initiatives focusing on enforcement, deterrence, and public awareness; and 3) facilitating referrals of cases with strong criminal implications to the DOJ and U.S. Attorney's Offices in order to better address consumer fraud issues.
- *Securities and Commodities Fraud Working Group.* The Securities and Commodities Fraud Working Group is a vehicle for public and private sector participants to discuss current trends in financial crime in the securities, futures, and option industries and to exchange ideas about enforcement techniques. The group, organized by the Fraud section of the Criminal Division of the DOJ, meets on a quarterly basis, and its members include criminal and regulatory authorities from state and Federal agencies and representatives from various exchanges and other SROs.

Executive Direction & Support

Administrative Management & Support. In FY 2004, the Commission began work on Project eLaw, an effort that provides law office automation and modernization to the Division of Enforcement, Office of the General Counsel, and Office of Proceedings. Project eLaw is a Commission-wide initiative that seamlessly integrates technology and work processes to support managers and staff across the Commission in their investigative, trial, and appellate work. Detailed planning and careful execution of Project eLaw tasks required extensive collaboration across the Commission to ensure all internal stakeholders had an opportunity to articulate their needs in this effort. In FY 2004, the requirements analysis, technology assessment, security plan and business impact analysis study were completed.

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Office of the General Counsel

Opinions and Review. Through its Opinions Program, OGC assists the Commission in the performance of its adjudicatory functions. In fulfilling this role, OGC drafts opinions and orders in matters appealed to the Commission. The Commission's jurisdiction in adjudicatory matters includes:

- Administrative cases prosecuted by the Enforcement program against alleged violators of the CEA or related regulations;
- Reparations cases brought by customers to recover money damages from industry registrants; and
- Adjudicatory actions taken by industry SROs disciplining members for alleged rule violations, denying applications for membership, or exercising delegated authority to resolve applications for Commission registration.

OGC reviews the records of cases subject to appeal, identifies decisional options for the Commission, and prepares draft opinions consistent with the Commission's instructions.

In FY 2004, OGC assisted with the resolution of appeals from initial decisions in administrative enforcement matters, appeals from initial decisions in reparations matters, and appeals arising out of SRO disciplinary actions.

The Commission issued 33 opinions and orders during FY 2004. Among other decisions, the Commission revisited its approach to imposing civil monetary penalties in light of guidance from a U.S. Court of Appeals. After the U.S. Court of Appeals vacated a penalty imposed by the Commission and remanded the case, the Commission stated that it would resume its prior practice of looking at cases of comparable gravity in assessing civil penalties. Comparing the instant facts to a comparable case, the Commission imposed a \$350,000 civil penalty, based on testimony by seven customers exposed to respondent's solicitation fraud. *In re Miller*, Docket No. 92-4 (CFTC July 23, 2004).

In another case involving the calculation of civil penalties, the Commission imposed a \$450,000 penalty for respondent's widespread use of a misleading sales pitch to market oil and gas options. *In re Staryk*, Docket No. 95-5 (CFTC July 23, 2004).

In another case, the Commission ruled that a presidential pardon, standing alone, does not nullify a statutory disqualification. The character of a pardoned individual who seeks to be registered remains subject to scrutiny in light of the conduct underlying the disqualification and pardon. *Hirschberg v. NFA*, Docket No. CRAA-02-03 (CFTC June 8, 2004)) (affirming a decision by the NFA).

The Commission decided two trade practice cases, finding liability against a single respondent in a case involving transactions in gold futures on the Commodity Exchange, Inc., *In re Gorski*, Docket No. 93-5 (CFTC Mar. 24, 2004); and dismissing the complaint against five individuals who traded various futures on three New York exchanges. *In re Fisher*, Docket No. 93-2 (CFTC Mar. 24, 2004).

The Commission also reached divergent results based on the facts of two cases involving off-exchange transactions in the agricultural market known as "hedge-to-arrive (HTA)" contracts. The Commission held that the HTA contracts in *In re Competitive Strategies, Inc.*, Docket No. 98-4 (CFTC Nov. 23, 2003) were off-exchange, and therefore illegal, futures contracts. It dismissed the complaint against respondents in *In re Grain Land Cooperative*, Docket No. 97-01 (CFTC Nov. 25, 2003), finding that the record did not establish reliably that the transac-

tions were futures contracts rather than forward contracts excluded from the Commission's jurisdiction.

In a third case involving off-exchange contracts used to manage agricultural price risk, the Commission summarily affirmed the initial decision's dismissal of the complaint based on the finding that respondent's "premium offer contracts" were not options, but rather forward contracts excluded from the Commission's jurisdiction. *In re Cargill*, Docket No. 99-16 (CFTC Nov. 25, 2003).

Litigation. Through the litigation program, OGC represents the Commission in the U.S. District Courts and the U.S. Courts of Appeals and assists the Solicitor General in representing the Commission before the U.S. Supreme Court. OGC also monitors litigation of interest to accomplishing the Commission's mission, including the Commission's cooperation with other Federal financial regulators through the President's Working Group on Financial Markets and the President's Corporate Fraud Task Force.

During FY 2004, before the Courts of Appeals, the Commission obtained favorable rulings upon a variety of issues. Most notably, the U.S. Court of Appeals for the Ninth Circuit confirmed the Commission's view of the professional integrity necessary to work as a commodity professional. Specifically, the court affirmed a Commission opinion that held that an individual may be denied a license to work as a CPO or as a CTA if that person has demonstrated a lack of honesty. *CFTC v. Stephen Bronte Advisors*, No. 02-73241 (9th Cir.) In another matter, the U.S. Court of Appeals for the Eleventh Circuit affirmed a district court finding of fraud in the retail sale of options contracts. *CFTC v. Matrix Trading Group*, No. 03-13123 (11th Cir.).

In a number of appellate matters, the Office of the General Counsel defended cases against violators of the CEA who failed to return funds to defrauded customers, among them, *CFTC v. Heffernan*, No. 03-14494D (11th Cir.), *CFTC v. Kingsfield*, No. 03-2413 (4th Cir), and *CFTC v. Wall Street et al.*, No. 04-3131 (10th Cir.). In addition, on behalf of the Commission, OGC affirmatively sought review before the U.S. Court of Appeals for the Seventh Circuit of the core jurisdictional issue regarding the definition of a futures contract. *CFTC v. Zelener*, No. 03-4245 (7th Cir.).

Before the U.S. District Courts, the Office of the General Counsel successfully defended the Commission's right to decide, subject only to appellate review, whether or not an individual has the requisite qualifications to serve as a FB in the commodities industry. *Hirschberg v. CFTC*, 2003 WL 22019310 (N.D.Ill.). In addition, OGC represented the Commission in personnel cases before the district courts, and before administrative agencies such as the Equal Employment Opportunity Commission and the Merit Systems Protection Board, and represented the Commission in contract matters before the General Services Board of Contract Appeals.

The Office of the General Counsel also monitors bankruptcy cases involving futures industry professionals and, as appropriate, assists courts, trustees, and customers in implementing special Bankruptcy Code provisions that pertain to commodity firms. In FY 2004, the Office of the General Counsel appeared before various Bankruptcy Courts throughout the country to protect both the Commission's interest in recovering penalties owed due to market misconduct and the interest of public customers in having their funds recovered and returned. Most notably, during FY 2004, OGC appeared in bankruptcy proceedings involving several firms alleged to have engaged in misconduct in the energy markets. *In re Enron Corp*, No. 01-16034 (S.D.N.Y.); *In re NRG Energy Inc.*, No. 03-13024 (S.D.N.Y.).

Finally, through its *amicus curiae* program, the Office of the General Counsel supports the Commission in assisting the courts in resolving difficult or novel questions arising under the CEA or Commission regulations with the intent of making significant contributions to the development of consistent and accurate legal precedent. In FY 2004, the Office actively considered participating as *amicus curiae* in one such case.

Regulatory and Legislative Matters. In FY 2004, OGC continued to advise the Commission concerning the implementation of rules and regulations issued pursuant to the CFMA. OGC assisted the Commission in new regulatory initiatives to further carry out CFMA mandates, including providing regulatory relief to market intermediaries as contemplated by the CFMA, such as amendments to Part 4 of the Commission's regulations governing the registration and activities of CPOs and CTAs.

OGC, working in conjunction with other programs of the Commission, consulted with staff of the U.S. Treasury Department and various Federal financial regulators to develop AML regulations required under the USA PATRIOT Act, including in FY 2004, a final rule requiring FCMs and IBs to report suspicious transactions. OGC also coordinated the Commission's continuing work with Treasury regarding a number of other regulations required by the USA PATRIOT Act that will impact the futures industry, including final rules requiring commodity pools, CPOs, CTAs, and securities investment advisers to establish AML compliance programs; and final rules governing the due diligence required for correspondent and private banking accounts for non-U.S. institutions and individuals. During FY 2004, OGC also actively participated in an inter-agency working group led by the Treasury Department to develop and issue guidance concerning the application of the recent customer identification program rules to the futures industry and other sectors of the financial services industry.

Many hedge fund complexes include registered CPOs and CTAs. In recognition of this growing and important market segment, OGC worked to prepare the Commission's "Backgrounder on the CPO and Commodity Pool Industry," which is posted on the Commission's Web site. Also during FY 2004, the General Counsel presented Commission testimony, including extensive hedge fund statistical data and related materials, at a hearing of the Senate Committee on Banking, Housing, and Urban Affairs on proposed regulation of the hedge fund industry.

Office of Proceedings

The Office of Proceedings provides a forum for effectively and expeditiously handling customer complaints against persons or firms registered with the Commission at the time of the alleged wrongdoing or at the time the complaint is filed.

During FY 2004, over 41 percent of the reparations complaints were disposed of within one year from the date the complaint was filed. The remaining complaints were not resolved within one year for reasons beyond the Commission's control. For example, parties requested additional time for one or more of the following reasons: 1) to submit supplementation to their cases; 2) to prepare pleadings; 3) to complete extensive discovery documents; or 4) to deal with personal or professional responsibilities.

The Office of Proceedings' ALJs are responsible for hearing and rendering decisions in administrative enforcement cases brought by the Commission against alleged violators of the CEA or related regulations. In FY 2004, the Office of Proceedings decided 45 administrative enforcement cases.

Summary of Performance—Goal Three

<i>Goal Three: Ensure market integrity in order to foster open, competitive, and financial sound markets.</i>			
Outcome 3.1: Clearing organizations and firms holding customer funds have sound financial practices.			
Annual Performance Goal: No loss of customer funds as a result of firms' failure to adhere to regulations. No customers prevented from transferring funds from failing firms to sound firms.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Lost funds:			
a) Percentage decrease in number of customers who lose funds	0	0	0
b) Amount of funds lost	\$0	\$0	\$0
Number of rulemakings to ensure market integrity and financially sound markets	1	1	4
Percentage of clearing organizations that comply with requirement to enforce rules	100%	100%	100%
Outcome 3.2: Commodity futures and option markets are effectively self-regulated.			
Annual Performance Goal: No loss of funds resulting from failure of self-regulated organizations to ensure compliance with their rules.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage of intermediaries who meet risk-based capital requirements	100%	100%	100%
Percentage of clearing organizations that comply with requirement to enforce their rules	100%	100%	100%
Outcome 3.3: Markets are free of trade practice abuses.			
Annual Performance Goal: Minimize trade practice abuses.			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage of exchanges deemed to have adequate systems for detecting trade practice abuses	100%	100%	100%
Percentage of exchanges that comply with requirement to enforce their rules	100%	100%	100%
Outcome 3.4: Regulatory environment is flexible and responsive to evolving market conditions.			
Annual Performance Goal: TBD			
Performance Measures	FY 2004 Plan	FY 2004 Est. Act.	FY 2004 Actual
Percentage of CFMA Section 126(b) objectives implemented	100%	100%	100%
Number of rulemakings, studies, interpretations, and guidance to ensure market integrity and exchanges' compliance with regulatory requirements	4	4	8
Percentage of requests for no-action or other relief completed within six months related to novel market or trading practices and issues to facilitate innovation	TBD	100%	100%
Percentage of total requests receiving CFTC responses for guidance and advice	90%	90%	100%

Goal Three

Clearing and Intermediary Oversight

Fostering Sound Business Practices: Oversight of SROs, Market Intermediaries, and DCOs. A key aspect of assuring effective self-regulation is oversight by the Commission of SRO programs to assure compliance by their members with customer and market protection standards. Toward this end, the Clearing and Intermediary Oversight program oversees, reviews, and reports to the Commission concerning statutorily required self-regulatory programs directed at maintaining the financial integrity of the markets and deterring improper sales practices and other wrongful conduct.

The Clearing and Intermediary Oversight program staff conduct a financial surveillance and audit program that buttresses periodic audit, daily financial surveillance, and other self-policing programs administered by the exchanges and NFA to promote and enhance effective self-regulation of the commodity futures and option markets. The objective of this program is to assure sound financial practices of clearing organizations and firms holding customer funds. The effort includes oversight of financial compliance programs of SROs and direct quality control audits to assess the efficacy of their programs. The oversight of SRO programs is necessary to ensure that SRO member firms are properly capitalized, maintain appropriate risk management capabilities, and that customer funds are held in segregation by appropriate custodians and are protected from misappropriation.

This oversight function of the Clearing and Intermediary Oversight program has taken on increased importance under the Commission's new regulatory framework under the CFMA. The CFMA defined a new category of registered entity, DCOs, and set forth certain core principles governing such entities. Staff also have developed a program for conducting oversight of DCO compliance and have met separately with each DCO to discuss the nature and content of this oversight program.

Similar to the approach of other federal financial regulators and certain overseas financial supervisors, - indeed, in close consultation with several such peers, - the Division has begun to enhance its supervision of exchanges, clearinghouses, and other SROs with risk-based examination cycles and risk-focused reviews. Both the scheduling and scope of the Division's supervisory reviews will now be based on careful analysis of the underlying risks to which an institution is exposed and the controls which it has in place to address those risks. This approach promises to better utilize supervisory resources and to help ensure even greater financial integrity and risk management within the firms and clearinghouses that are the backbone of the futures clearing system.

The Major Reviews unit, one of two new units within the Division, was created during FY 2004 to plan, coordinate, schedule, monitor, and assess major risk-focused reviews. The unit's activities are intended to ensure that multiple, simultaneous major reviews are completed on schedule, follow appropriate benchmarks of consistency and comparability, and, ultimately, provide meaningful assessments of core principle compliance which, when presented formally to the Commission, permit the Commissioners to assure themselves that the Commission is fulfilling its responsibilities on this important aspect of market oversight.

The Clearing and Intermediary Oversight program staff completed six audits (one exchange clearinghouses and five FCMs) in FY 2004 to test compliance with the Commission's financial requirements for the safekeeping of customer funds. In addition, program staff processed 4,671 financial reports filed by registrants. As a

result of ongoing program efforts such as these, no regulated customer funds were lost in FY 2004, thereby meeting the program's objective of ensuring sound financial practices of clearing organizations and firms holding customer funds.

Ensuring a Flexible and Responsive Regulatory Environment. In FY 2004, the Clearing and Intermediary Oversight program supported the Commission's ongoing regulatory reform program, as well as actions required by or appropriate to the implementation of the CFMA. In February 2004, the Commission amended its rules to further expand the range of permissible investments by FCMs and clearinghouses of their customers' funds and property, which will now be permitted to enter into repurchase agreements and collateral management programs using customer-deposited securities. In April 2004, Clearing and Intermediary Oversight staff issued a letter clarifying application of the CPO exemption that was adopted in August 2003 as Rule 4.13(a)(3). The letter stated that a CPO claiming registration exemption under Rule 4.13(a)(3) may admit Non-U.S. persons (as defined in Rule 4.7) as participants in the CPO's pool *without* regard to whether such Non-U.S. persons meet the investor qualifications set forth in Rule 4.13(a)(3)(iii). In light of the Staff Letter, staff developed an amendment to Rule 4.13(a)(3), adopted by the Commission in July 2004, that provides that if a person can participate in a Rule 4.13(a)(4) pool, which has no trading restrictions, the person similarly should be able to participate in a Rule 4.13(a)(3) pool, which does have a trading restriction, without requiring the operator of the pool to register as a CPO.

Exemptive, Interpretive, and No-Action Relief. The Clearing and Intermediary Oversight program is responsible for providing exemptive, interpretive, or other relief to facilitate the continued development of an effective, flexible regulatory environment responsive to evolving market conditions. The Clearing and Intermediary Oversight program responded to a high number of formal and informal requests for guidance concerning the application of regulatory requirements to specific transactions, new products, and market circumstances. Staff issued 176 responses to written requests, including electronic responses, from members of the public and the regulated industry to provide guidance concerning the application of Commission rules and to provide exemptions. The average response time was five weeks. Staff also responded to more than 1,750 telephone inquiries concerning the application of Commission requirements to commodity professionals. These responses aided market participants and the public by providing guidance concerning the manner in which they may conduct their activities to comply with relevant requirements and by granting relief from requirements where application of the rules would not serve the public interest.

The Commission also furthered the development of the foreign futures and option transactions (U.S. customers trading on non-U.S. markets) in FY 2004. The Commission issued an order to the U.K. Financial Service Authority (FSA) consolidating and updating the relief set forth in prior orders issued pursuant to Commission Rule 30.10, reflecting the substitution of the FSA for various U.K. regulatory and SROs and revising certain staff no-action letters regarding the treatment of customer funds attributable to trading on the London Metals Exchange. Among other things, the Commission's order exempted firms designated by the FSA from compliance with the Commission's risk disclosure requirements as they apply to transactions under Part 30, and authorized such firms to permit U.S. customers that are eligible contract participants to opt out of segregation with respect to foreign futures and options transactions. Conference calls were conducted with representatives of each of the foreign exchanges that are recipients of Rule 30.10 relief to update information about contact persons, regulatory reform and structural changes at each exchange, and the accuracy of NFA's list of Rule 30.10 firms at each foreign exchange. These calls also solicited comments

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from the Rule 30.10 foreign exchanges about any need for amendments to their respective Rule 30.10 orders.

Security Futures Products and Cooperation with the SEC. The CFMA also directs the Commission and the SEC to implement a joint regulatory framework for SFPs and narrow-based stock index futures. As part of the ongoing security futures product supervisory and oversight process, the Commission and the SEC signed an MOU to clarify the ability of each agency to conduct inspections of notice-registered intermediaries, exchanges, and limited purpose national securities associations. The MOU provides that the CFTC and SEC will notify each other of any planned examinations, advise the other of reasons for an intended examination, provide each other with examination-related information, and conduct examinations jointly, if feasible. The agencies will notify each other of significant market issues and will share trading data and related market information.

The Clearing and Intermediary Oversight program permitted NFA to postpone indefinitely updating the Series 3 and Series 30 examinations to include questions on SFPs. Staff has discussed with NFA and National Association of Securities Dealers how to accomplish eventual updating of the examinations, but, for the time being, salespersons will be permitted to continue to offer SFPs following the taking of a web-based training module. The SEC is in accord with this approach.

Enforcement

Trade Practice Actions. The legislative history of the CEA notes that one of the fundamental purposes of the Act is to ensure fair practices and honest dealing in the futures market and to control those forms of speculative activity that demoralize the market to the detriment of producers, consumers, and the markets. Consistent with Congress' mandate, the Commission brings trade practice cases to address a variety of unfair, abusive, or deceptive ploys by traders to avoid exposing their orders to market risk. Such actions can create non-competitive prices in the marketplace and have the potential to harm public customers, producers, and others. Improper trade practices include a variety of activities, including trading done in violation of exchange rules, such as trading ahead of a customer order, wash trading, accommodation trading, and fictitious trading. Cases in this area during FY 2004 included:

In re Contrino, Disarro, Overland, and Paulino, Docket No. 02-13 (January 7, 2004). The Commission issued an order finding that Contrino, Disarro, and Paulino fraudulently executed trades in the coffee futures ring of the CSCE. Contrino, Disarro, Overland, and Paulino were required to pay civil monetary penalties and were suspended as follows: Contrino—\$90,000 and four-month suspension; Disarro—\$50,000 and six-month suspension; Overland and Paulino—\$60,000 and six-month suspension each; *In re Robert Benjamin Harmon*, Docket No. 03-25 (January 16, 2004). The Commission issued an order against Robert Benjamin Harmon, Jr., finding that Harmon and another floor broker unlawfully executed crude oil futures trades on the NYMEX. The Commission found that Harmon engaged in wash sales and reported non *bona fide* prices. Harmon was ordered, among other sanctions, to pay a civil penalty in the amount of \$8,500; *In re Olam International Limited*, Docket No. 04-13 (April 6, 2004). The Commission issued an order against Olam International Limited, a company incorporated in Singapore, based on illegal wash trading on the CSCE. The Commission found that on two occasions in June and July 2002, an Olam trader engaged in wash sales, and ordered Olam to pay a \$20,000 civil monetary penalty; *In re Barry Callebaut Sourcing AG*, Docket No. 04-16 (May 13, 2004). The Commission issued an order against respondent relating to illegal wash trading on the CSCE. The order found that on two separate occasions, in November 2001 and July 2002, Barry engaged in wash sales, and imposed a \$25,000 monetary

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penalty and other sanctions; *In re Daniel J. Collins, Thomas M. Gianos, Bernard Miraglia, John R. Wade, and Edward M. Collins*, Docket No. 94-13 (July 20, 2004). The Commission issued an order against respondents that found that during the late 1980s, a trader established commodity futures intermarket spread transfer trades, as well as made fictitious and non-competitive transfer trades. The Commission permanently prohibited all respondents except Gianos from trading on or subject to the rules of a contract market, and barred respondent Gianos from trading for six months; *In re Izmir Mehmedovic*, Docket No. 04-23 (August 24, 2004). The Commission order found that on September 18, 2002, Mehmedovic violated the anti-fraud provisions of the CEA by knowingly engaging in at least one instance of trading ahead of an executable customer order. The order imposed various sanctions on Mehmedovic, including a \$10,000 civil monetary penalty, a three-month suspension of his floor broker registration, and an 18-month prohibition on trading for others; and *Credit Lyonnais Rouse Ltd.*, Docket No. 04-25 (September 29, 2004); *In re Fimat International Banque SA (UK Branch)*, Docket No. 04-26 (September 29, 2004); and *In re Refco Overseas Ltd.*, Docket No. 04-27 (September 29, 2004). The Commission issued an order in each of these actions that found that the respondent knowingly participated in illegal wash trading on the Coffee, Sugar & Cocoa Exchange. Each of the respondents was ordered to pay a \$25,000 civil penalty and comply with specified undertakings.

Domestic Cooperative Enforcement. The Commission's cooperative enforcement efforts are an important part of its ability to promote compliance with and deter violations of Federal commodities laws. Cooperative enforcement enables the Commission to maximize its ability to detect, deter, and impose sanctions against wrongdoers involving U.S. markets, registrants, and customers. The benefits of cooperative enforcement include: 1) the use of resources from other sources to support Commission enforcement actions; 2) coordination in filing actions with other authorities to further the impact of enforcement efforts; and 3) development of consistent and clear governmental responses and avoidance of duplication of efforts by multiple authorities.

As in the past, staff of the Division of Enforcement have coordinated with numerous Federal, state, and self-regulatory authorities. Historically, program staff have sought assistance from or provided assistance to various Federal agencies, such as the Department of Justice, Federal Bureau of Investigation, SEC, the U.S. Postal Inspection Service, and the Internal Revenue Service (IRS). Similarly, Division staff have provided assistance to and/or received assistance from state authorities, such as agencies responsible for the regulation of corporations, securities, and banking. The Commission also has provided Federal and local law enforcement authorities with testimony or other assistance in connection with criminal investigations. Enforcement staff have worked with DOJ and various U.S. Attorney's offices throughout the nation, the FBI, the offices of numerous state attorneys general, local police authorities, and task forces focusing on areas such as corporate fraud and foreign currency fraud.

International Cooperative Enforcement. The Commission continues to coordinate enforcement activities with foreign authorities. During FY 2004, the Commission made 113 requests for assistance to 56 foreign authorities, and it received 27 requests from authorities in foreign jurisdictions. In particular this year, the Commission was successful in freezing assets and obtaining bank records in several jurisdictions where we did not have prior cooperative relationships. Overall, during FY 2004, the Commission froze foreign assets totaling approximately \$4.1 million in five enforcement actions.

The Division also has devoted time and resources to matters involving cross-border activities necessitating assistance from the Commission's international

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counterparts. Such activities can adversely affect U.S. firms as well as customers located in the U.S. and overseas.

The Commission's international information-sharing arrangements enable the Commission and foreign authorities to engage in the bilateral sharing of information to assist each other in the investigation of potential wrongdoing that extends beyond their respective borders. During FY 2004, the Commission continued its work on the International Organization of Securities Commissions' (IOSCO) Multilateral Memorandum of Understanding (MMOU) Concerning Consultation, Cooperation, and the Exchange of Information. The MMOU is an important and meaningful undertaking for regulators to expand cooperation by establishing specific minimum standards for securities and futures regulators in the area of information sharing. There are 26 MMOU signatories, including nine foreign authorities with whom the Commission did not have an information-sharing arrangement previously.

Division staff, along with three other foreign regulators as members of a MMOU Verification Team, evaluated the applications of four IOSCO members to become signatories to the MMOU this year. The Commission also is part of the Screening Group that makes recommendations to a decision-making body of IOSCO concerning whether to accept or reject specific MMOU applications.

Division staff participated in the IOSCO Task Force on Client Identification to determine a range of acceptable options for client identification in the securities and futures industry. In May 2004, the Task Force released a report that may be found at:

<http://www.iosco.org/library/index.cfm?whereami=pubdocs>.

During FY 2004, Division staff also continued to participate in the Standing Committee on Enforcement and Information-Sharing (SC4) of the Technical Committee of IOSCO. SC4 considers issues and formulates recommendations relating to international assistance in the detection, investigation, and prosecution of securities and futures violations.

Information-Sharing Arrangements. The Commission's international information-sharing arrangements enable the Commission and foreign authorities to engage in the bilateral sharing of information to assist each other in the investigation of potential wrongdoing that extends beyond their respective borders.

- Statement of Intent - Irish Financial Services Regulatory Authority. On March 17, 2004, the Commission and Irish Financial Services Regulatory Authority (IFSRA) signed a Statement of Intent (SOI) Concerning Consultation and Cooperation in the Administration and Enforcement of Futures Laws. The SOI provides a framework for information sharing, thereby facilitating cooperation in cross-border investigations of potential violations of commodity futures and options laws. The Commission's arrangement with the IFSRA is the 23rd formal bi-lateral arrangement that the Commission has entered into for enforcement information sharing with its counterparts in other countries.
- IOSCO Multilateral Memorandum of Understanding. During FY 2004, the Commission continued its work on the IOSCO Multilateral Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information (MMOU). The MMOU is an important and meaningful undertaking for regulators to expand cooperation by establishing specific minimum standards for securities and futures regulators in the area of information sharing. There are

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26 MMOU signatories, including nine foreign authorities that the Commission did not have an information-sharing arrangement with previously.

International Organization of Securities Commissions (IOSCO)

- Screening and Approving MOU Applicants. Division staff along with three other foreign regulators as members of a MMOU Verification Team evaluated the applications of five IOSCO members to become signatories to the MMOU. The Commission also is a member of the Screening Group which makes recommendations to a decision making body of IOSCO concerning whether to accept or reject specific MMOU applications. In FY 2004, the Screening Group reviewed approximately 10 applicants for the MMOU.
- Client Identification Task Force. The Division staff participated in the IOSCO Task Force on Client Identification to determine a range of acceptable options for client identification in the securities and futures industry. The Task Force's work resulted in IOSCO's publication in May 2004 of its *Principles On Client Identification And Beneficial Ownership For The Securities Industry*.
- Standing Committee 4. During FY 2004, Division staff also continued to participate in the Standing Committee on Enforcement and Information-Sharing (SC4) of the Technical Committee of IOSCO. SC4 considers issues and formulates recommendations relating to international assistance in the detection, investigation, and prosecution of securities and futures violations.

Executive Direction & Support

Agency Direction. The Agency Direction subprogram, specifically OIA, assists the Commission in the formulation of international policy by: 1) coordinating with foreign regulatory authorities; 2) participating in international regulatory organizations and forums; and 3) providing technical assistance to foreign governmental bodies. In FY 2004, OIA contributed to this effort by:

- Coordinating Commission activities within IOSCO and its Technical Committee and standing committees, with special focus on issues raised by index products, short-selling, transparency, error trade policies, cross-border activities of intermediaries, outsourcing and compliance functions;
- Participating in several IOSCO Task Forces, including chairing the IOSCO Implementation Task Force that completed drafting an assessment methodology for the *IOSCO Objectives and Principles of Securities Regulation*, which was adopted by IOSCO, developed an electronic version of the Assessment methodology and instructions to clarify its application and participated in IOSCO seminars in Spain and India explaining the methodology; participating in the IOSCO-CPSS Task Force on Central Counterparties that developed a combined risk management and default procedure recommendations and assessment methodology for central counterparties, which was published by IOSCO and the CPSS; and participating in an IOSCO Chairs' Committee, which examined ways to strengthen capital markets against financial fraud and issues concerning the activities of credit rating agencies;

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- Providing information to the IOSCO Emerging Markets Committee on its approach to detecting and deterring manipulation and other matters;
- Coordinating Commission representation in the Council of Securities Commissions of the Americas (COSRA), including contributing a paper on the benefits of futures trading to the securitization of small business loans and participating on ways to conduct a needs assessment and otherwise how to advance COSRA's regional technical assistance and training initiatives;
- Providing expertise to the Committee of European Securities Regulators related to their inquiry into acceptable market practices for commodity markets as part of its deliberations on possible expansion of the Investment Services Directive to commodity markets;
- Participating in the Joint Forum's initiative to develop principles for outsourcing relevant to securities, banking and insurance firms;
- Providing assistance to the Financial Sector Assessment Program of the World Bank and International Monetary Fund;
- Coordinating the development of an arrangement for regulatory cooperation, consultation and the provision of technical assistance with the Securities Exchange Board of India.
- Coordinating the Commission's provision of representations and regulatory information to regulatory authorities in Australia, Austria, Germany, Italy, the Netherlands, Spain and Switzerland that supported the recognition of three U.S. futures exchanges electronic trading systems and provided regulatory information to assist Australian regulators determination to issue a blanket exemption to U.S. FCMs offering wholesale business in Australia;
- Coordinating the Commission's comments to the U.S. Treasury Department on various position papers including U.S.-India and U.S.-China dialogue;
- Organizing the annual meeting for international regulators during the Futures Industry Association conference, focusing on international regulatory approaches to governance and self-governance of organized markets;
- Participating in and advising the Toronto Centre on leadership with respect to securities and derivatives sector programs and participating in a cross-sectoral executive forum involving insurance and banking as well as securities;
- Responding to requests from domestic and international financial regulators for information on the Commission's program and commenting on various reports;
- Obtaining fitness information from foreign regulators to support the NFA's registration program and responding to requests from foreign regulators for fitness information on Commission registrants that resulted in recognition of US intermediaries abroad;
- Assisting NFA in designing and promoting its Regulatory Alert System, which provides regulatory information on Commission registrants to participating regulators;

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- Providing technical assistance to foreign regulators in FY2004 through visits with staff at the Commission by 89 foreign persons representing 14 foreign jurisdictions, two on-site visits by Commission staff to foreign jurisdictions, and a week-long seminar in Chicago that examined the techniques used to promote market, firm, and customer protections. Sharing this information enhances the knowledge of other regulators and facilitates the development of high levels of global regulatory protections. In FY 2004, 64 persons representing 25 regulatory and market authorities from 44 jurisdictions attended the seminar.

Administrative Management & Support. In FY 2004, the Commission implemented a new system, Stressing Positions at Risk (SPARK) that can analyze the financial positions of trading firms in relation to changing market conditions. This application was developed to perform analysis of existing market conditions and conduct “what if” analyses on future changes in support of financial oversight and risk analysis of the futures market.

Office of the General Counsel

OGC continued its review of requests for no-action relief to allow the offer and sale of foreign exchange-traded foreign stock index futures contracts in the U.S. In FY 2004, OGC issued four no-action letters for six of these foreign exchange-traded foreign stock index futures contracts.

During FY 2004, OGC advised the Commission with respect to legislative provisions affecting the Commission that were included in the Conference Report on the Energy Policy Act, H. Rep. No. 108-375. These included proposals to: 1) amend Section 4b of the CEA to provide the Commission with principal-to-principal anti-fraud authority; 2) amend Section 9 of the CEA to clarify the Commission's false reporting authority; and 3) add savings clauses to the Federal Power Act and the Natural Gas Act to preserve the Commission's exclusive jurisdiction over market futures and options trading data.

OGC staff also continued to participate in IOSCO's Standing Committee 5 (SC5) on Investment Management. During the year, SC5 considered and issued reports on several topics of importance to collective investment vehicles. With respect to AML, OGC also participated in the development of the Principles issued by the IOSCO Task Force on Client Identification and Beneficial Ownership in May 2004.

Market Oversight

In FY 2004, Market Oversight's Market Compliance subprogram staff completed three rule enforcement reviews of SRO compliance programs. Periodic review of self-regulated organization compliance programs is a component of the program's oversight activity to promote and enhance effective self-regulation and ensure that SROs enforce compliance with their rules.

One of the rule enforcement reviews completed during FY 2004 was a review of the Coffee, Sugar and Cocoa Exchange's (CSCE's) audit trail, trade practice surveillance, disciplinary and dispute resolution programs. Market Compliance staff found that CSCE maintains adequate programs with respect to the areas reviewed, but made recommendations to further improve CSCE's trade practice surveillance and disciplinary programs. Staff recommended that CSCE modify its procedures for monitoring cross trades and impose consistently meaningful sanctions in cases involving similar substantive trading abuses. Market Compliance staff also conducted a review of the New York Mercantile Exchange's (NYMEX's) trade practice, audit trail, disciplinary, and dispute resolution programs. In its

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review, staff found that NYMEX maintains adequate programs in these areas, and made recommendations to further improve certain aspects of its disciplinary program. Finally, staff conducted a review of the Minneapolis Grain Exchange's (MGE) market surveillance, trade practice surveillance, audit trail, disciplinary, and dispute resolution programs. Similarly, staff found that MGE maintains adequate programs in these areas and made recommendations for further improvement.

The Commission's review of exchange rules is a key aspect of the statutory framework for self-regulation. Market and Product Review subprogram staff review exchange rule submissions with the goals of: 1) maintaining the fairness and financial integrity of the markets; 2) protecting customers; 3) accommodating and fostering innovation; and 4) increasing efficiency in self-regulation consistent with the Commission's statutory mandates. To these ends, the Market and Product Review staff reviewed 263 exchange rule submission packages and, within those packages, staff reviewed 2,669 new rules and rule amendments.

Market and Product Review subprogram staff also work to facilitate industry innovations and new trading methods and market structures, thereby meeting the Commission's objective of promoting and enhancing effective self-regulation and competition. During FY 2004, staff was involved in a number of significant matters including issues related to new exchanges and exempt markets, exchange mergers, novel products and trading procedures, and new automated trading systems.

Issuing Exemptive, Interpretive, and No-Action Relief

The Division of Market Oversight (DMO) program is responsible for providing exemptive, interpretive, or other relief to facilitate the continued development of an effective, flexible regulatory environment responsive to evolving market conditions. For example, in FY 2004, DMO issued an interpretative letter to the Australian Wheat Board (AWB) which found that AWB's proposal to have its wholly-owned subsidiary, AWB (USA), Inc., conduct over-the-counter trading, both as an offeror and an offeree of agricultural trade option contracts, fell within the exemptive provisions of regulation 32.13(g).

The Commission continued the policy initiated in FY 1999 of issuing no-action letters in response to requests by foreign boards of trade to permit placement of electronic terminals in the U.S. without requiring contract market designation for those boards of trade. In FY 2004, DMO handled foreign terminal no-action letter requests from the European Energy Exchange, and the Winnipeg Commodity Exchange. (Responsive relief letters were issued to those exchanges respectively on October 25 and December 15.) DMO also considered requests for amended no-action letters from Eurex Deutschland and Eurex Zurich, Ltd., to permit the clearing of Euro products traded on the two exchanges to be cleared by the Clearing Corporation as a special clearing member of Eurex Clearing AG and from the Sydney Futures Exchange (SFE) to permit non-clearing SFE members that carry U.S. customer accounts to place SFE terminals with those customers conditioned on the non-clearing member giving up those trades to a guaranteeing FCM or rule 30.10 firm. (Responsive relief letters were issued to both of those requests on October 25, 2004.)

Office of Proceedings

The Office of Proceedings continued to hear and decide administrative enforcement actions brought by the Commission.

Commodity Futures Trading Commission

Summary of Financial Management Plan

The President's Management Agenda initiatives for improving financial performance, expanding electronic government, and integrating budget and performance have resulted in the passage of the Accountability of Tax Dollars Act, Improper Payments Information Act, E-Government Act, and eTravel Service requirements. These new legislative mandates significantly impact the Commission's business processes that support its mission, goals, and outcomes. To comply with these mandates will require modernization of the Commission's financial management and travel systems to Web-centric, end-to-end enterprise architecture solutions.

In FY 2004, the Commission completed its first submissions of year-end audited financial statements, and a consolidated Performance and Accountability Report. In FY 2005, the Commission will also complete an assessment of its business processes and financial management systems, including travel. This assessment will provide the basis for developing a strategic plan for acquiring and implementing financial management and eTravel system solutions that are fully compliant with the new legislative mandates associated with the President's Management Agenda.

In FY 2005, the Commission will continue complying with financial statement and performance and accountability reporting requirements, including quarterly submission of unaudited financial statements. In addition, the Commission plans to acquire and implement financial management and eTravel systems that provide Web-centric, end-to-end enterprise architecture solutions for supporting the President's Management Agenda.

Table of Acronyms

AAC	Agricultural Advisory Committee
ALJ	Administrative Law Judge
AML	Anti-Money Laundering
AP	Associated Person
ASXF	ASX Futures Exchange Proprietary Limited (Australia)
AWB	Australian Wheat Board
BASIC	Background Affiliation Status Information Center
BC/DR	Business Continuity and Disaster Recovery
BOTCC	Board of Trade Clearing Corporation
BPA	Blanket Purchase Agreement
BSE	Bovine Spongiform Encephalopathy
CBOT	Chicago Board of Trade
CCORP	The Clearing Corporation
CDXCHANGE	Commodities Derivative Exchange, Inc.
CEA	Commodity Exchange Act
CESR	Committee of European Securities Regulators
CFTC	Commodity Futures Trading Commission
CFMA	Commodity Futures Modernization Act of 2000
CME	Chicago Mercantile Exchange
COSRA	Council of Securities Regulators of the Americas
CPO	Commodity Pool Operator
CSCE	Coffee Sugar and Cocoa Exchange
CTA	Commodity Trading Advisor
DCIO	Division of Clearing and Intermediary Oversight (CFTC)
DCO	Derivatives Clearing Organization
DMO	Division of Market Oversight (CFTC)
DOI-NBC	Department of Interior's National Business Center
DOJ	Department of Justice
DTEF	Derivatives Transaction Execution Facility
EAP	Employee Assistance Program
EBOT	Exempt Board of Trade
ECM	Exempt Commercial Markets
EEX	European Energy Exchange
EMC	Executive Management Council
EOL	Enron Online
ERC	Employee Resource Center
eTS	eTravel Service
FB	Floor Broker
FBI	Federal Bureau of Investigation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FCA	Farm Credit Administration
FCM	Futures Commission Merchant
FERC	Federal Energy Regulatory Commission
FFOB	Foreign Futures and Options Brokers
FIA	Futures Industry Association
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
FMHA	Farmers Home Administration
FOIA	Freedom of Information Act
FOREX	Foreign Currency

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FRB	Board of Governors of the Federal Reserve System
FSA	U.K. Financial Service Authority
FTE	Full-time Equivalent
FY	Fiscal Year
GAO	General Accounting Office
GLBA	Gramm-Leach-Bliley Act
GMAC	Global Markets Advisory Committee
GPRA	Government Performance and Results Act
GSA	General Services Administration
IA	Investment Advisor
IB	Introducing Broker
IPE	International Petroleum Exchange
IOSCO	International Organization of Securities Commissions
IRS	Internal Revenue Service
ISS	Integrated Surveillance System
JAC	Joint Audit Committee
JO	Judgment Officer
KCBT	Kansas City Board of Trade
LCH	London Clearing House
LIBOR	London Interbank Offered Rate
LIFFE	London International Financial Futures and Options Exchange
MASC	Management Accounting Code Structure
MCO	Multilateral Clearing Organization
MGE	Minneapolis Grain Exchange
MMOU	Multilateral Memorandum of Understanding
MOU	Memorandum/Memoranda of Understanding
NFA	National Futures Association
NGX	Natural Gas Exchange
NYBOT	New York Board of Trade
NYCE	New York Cotton Exchange
NYFE	New York Futures Exchange
NYMEX	New York Mercantile Exchange
OCC	The Options Clearing Corporation
OCE	Office of Chief Economist (CFTC)
OCX	OneChicago Futures Exchange
OED	Office of the Executive Director (CFTC)
OFM	Office of Financial Management (CFTC)
OGC	Office of the General Counsel (CFTC)
OHR	Office of Human Resources (CFTC)
OIA	Office of International Affairs (CFTC)
OIRM	Office of Information Resources Management (CFTC)
OMB	Office of Management and Budget
OMO	Office of Management Operations (CFTC)
OPM	Office of Personnel Management
OTC	Other-the-Counter
PMA	President's Management Agenda
PWG	President's Working Group on Financial Markets
RFA	Registered Futures Association
SC4	Standing Committee on Enforcement and Information Sharing
SC5	IOSCO's Standing Committee 5 on Investment Management
SEC	Securities and Exchange Commission
SFE	Sydney Futures Exchange

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SFP	Security Futures Products
SRO	Self-Regulatory Organization
TAC	Technology Advisory Committee
TFS	Traditional Financial Services Pulp and Paper Division
TRADE	Trade Practice Surveillance System
SPARK	Stress Positions at Risk
USA PATRIOT	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism
USDA	United States Department of Agriculture
USFE	U.S. Futures Exchange, L.L.C. (Eurex US)
UK	United Kingdom
WAN	Wide Area Network
WCE	Winnipeg Commodity Exchange

Privacy Policy for CFTC Web Site

The purpose of this policy statement is to describe how the Commission handles information learned about visitors when visitors access the CFTC Web site. The information the Commission receives depends on how the visitor uses the Web site. Visitors are not required to give personal information to visit the site.

If a visitor accesses the CFTC Web site to read or download information, such as press releases or publications, the Commission will collect and store the following information:

- The name of the domain (the machine or Web site) from which the visitor accesses the Internet (for example, aol.com if a visitor is connecting from an America Online account) and/or the name and Internet protocol address of the server the visitor is using to access the CFTC Web site;
- The name and Internet protocol address of the CFTC server that received and logged the request;
- The date and time the request was received;
- The information that the visitor is accessing (for example, which page or image the visitor chose to read or download); and
- The name and version of the Web browser used to access the Web page.
- The Commission uses the information collected to measure the number of visitors to the different sections of its Web site and to help us make the Web site more useful to visitors.

The Commission does not enable "cookies." A "cookie" is a text file placed on a visitor's hard drive by a Web site that can be used to monitor his or her use of the site.

If a visitor completes a form or sends a comment or e-mail, he or she may be choosing to send us information that personally identifies him or her. This information is used generally to respond to the visitor's request, but may have other uses that are identified on each form. For example, if a visitor sends the Commission a comment letter on a proposed regulation, that letter becomes part of the comment file and is available to the public. The comments are used to help CFTC and other members of the public evaluate proposed Commission actions. Other forms that a visitor may choose to submit, such as FOIA requests or requests for correction of information, contain information that is used by the Commission to track and respond to visitors' requests. Information provided on the enforcement questionnaire may be shared with other law enforcement agencies, if appropriate.

Questions about CFTC's privacy policy and information practices should be directed by e-mail to webmaster@cftc.gov. Information on the Commissions systems of records maintained under the Privacy Act can be found under Section D of the *CFTC Federal Register* Notices.



COMMODITY FUTURES

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